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Insights into the effectiveness of internal audit: a multi-method and multi-perspective study

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UNIVERSITÉ CATHOLIQUE DE LOUVAIN
Louvain School of Management

Insights into the effectiveness of internal audit: a multi-method and multi-perspective study

Rainer LENZ

Doctoral dissertation submitted for the academic degree
of *Philosophiae Doctor* in Economics and Management Science

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To my wonderful wife Stefanie – jed

“Only practice contains all theory.”
(Kappler 1988)

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Dreieich, February 2013 Rainer Lenz

TABLE OF CONTENT

Page

GENERAL INTRODUCTION **2**

PAPER 1 ..... **20**

IN SEARCH OF A MEASURE OF EFFECTIVENESS FOR INTERNAL AUDIT FUNCTIONS: AN INSTITUTIONAL PERSPECTIVE **20**

Abstract **20**

1. Introduction **22**

2. Define effectiveness as a 'risk based goal-attainment concept that helps the organization to achieve its objectives' **24**

3. Introduction of institutional theory **27**

4. Coercive isomorphism **30**

5. Normative isomorphism **34**

6. Mimetic isomorphism **37**

6.1 Is there an institutionalized model of the relationship between IA and SM? ..38
6.2 Is there an institutionalized model of the relationship between IA and the board/AC? 40
6.3 Is there an institutionalized model of the relationship between IA and EA? ...41
6.4 Are there general institutionalized IA models to mimic? 44

7. Discussion **46**

7.1 IA effectiveness is contextually dependent 46
7.2 Institutional forces can result in increasing IA effectiveness 47
7.3 Institutional forces may differ in levels of strengths, and they may diverge ...49
7.4 Organizational hypocrisy may be a solution in practice 51
7.5 Institutional entrepreneurship may be a solution in practice 51

8. Conclusion **54**

References **60**

PAPER 2 ..... **72**

FACTORS ASSOCIATED WITH THE INTERNAL AUDIT FUNCTION'S ROLE IN CORPORATE GOVERNANCE **72**

Abstract **72**

Introduction **74**

1. Literature Review and Hypotheses **75**

1.1 IIA Standards 75

1.1.1 Use of a risk-based audit plan....76
1.1.2 Quality assurance and improvement program.....76
1.1.3 Input from other Corporate Governance Stakeholders....77
1.2 Control Variables....78

2. Research Method....79

3. Results....81

3.1 Univariate Statistics....81
3.2 Multivariate Statistics....83

4. Summary, Limitations, and Conclusions....86

4.1 Summary....86
4.2 Limitations....86
4.3 Conclusions....87

References....90

PAPER 3....96

REFLECTIONS ON THE INTERNAL AUDITING PROFESSION: WHAT MIGHT HAVE GONE WRONG?....96

Abstract....96

Introduction and background....97

1. Silence on internal auditing in the governance debate....99

2. Value of IA questioned....100

2.1 Big holes in practice when comparing factual and targeted scope of IA services....101
2.2 Absence of clearly conveying value added to major stakeholders....101
2.3 Overly optimistic self-assessments by internal auditors....103

3. Internal auditing has no clear chief stakeholder/"boss"....104

4. Internal auditing has no clear role....109

5. Conclusions, latest changes in the IIA Standards, and future research directions....112

References....116

PAPER 4....124

TESTING THE DISCRIMINATORY POWER OF CHARACTERISTICS OF INTERNAL AUDIT FUNCTIONS: SORTING THE WHEAT FROM THE CHAFF 124

Abstract....124

Introduction and research question....126

1. Conceptual considerations of what constitutes IA effectiveness....128

2. The reference model has four building blocks....129

3. The snapshot questionnaire that underpins the four building blocks 130

3.1 Reference model, building block number one: organizational characteristics 130
3.2 Reference model, building block number two: IA resources (people) 131
3.3 Reference model, building block number three: IA processes.....134
3.4 Reference model, building block number four: pattern of relationships.....137
3.5 Overall firm characteristics 140

4. Data collection.....140

5. Findings 142

6. Discussion of results.....144

6.1 Fourteen questions with discriminatory power 145
6.1.1 IA charter exists and is agreed by the board/AC (IA_C, Q8) 145
6.1.2 Next move of IA staff is generally a lateral move or a promotion (NEXT, Q10).....145
6.1.3 Combined share of co-sourcing and outsourcing of IA services is 1-40% (CO_S, Q11) 145
6.1.4 Training of IA staff is 40 hours per year or more (TRA_IA, Q12).....146
6.1.5 CAE has a professional IA qualification (Q_CAE, Q16).....146
6.1.6 IA staff are required to have a professional IA qualification (Q_IA, Q17).....147
6.1.7 IAF uses Computer Assisted Auditing Techniques (CAAT, Q19) 147
6.1.8 Risk-based IA is applied to determine priorities of the IA activity (RBIA, Q21).....147
6.1.9 Senior management provides input to the IA plan (SM_INPUT, Q24) 147
6.1.10 Board/AC provides input to the IA plan (AC_INPUT, Q25).....147
6.1.11 IA makes recommendations for improving the governance process (IA_GOV, Q26) 148
6.1.12 IA rates individual findings and grades the overall report (GRADE, Q29).....148
6.1.13 CAE has appropriate access to the board/AC (IA-AC_1, Q35).....148
6.1.14 CAE is contacted informally by SM, min. 3-4 times p.a. (IA-SM_3, Q40).....149
6.2 Discussion of overall firm characteristics 149

7. Limitations.....150

8. Summary, conclusion, and suggestions for further research 151

8.1 Summary 151
8.2 Conclusion.....151
8.2.1 Micro-level findings 152
8.2.2 Macro-level findings 154
8.3 Suggestions for further research.....155

Appendix 158

Appendix A: Snapshot questionnaire, German version translated into English 159

Appendix B: Scoring model.....168

References 169

PAPER 5 178

INTERNAL AUDIT EFFECTIVENESS: MULTIPLE CASE STUDY RESEARCH IN GERMANY APPLYING ROLE THEORY AND THE RELATIONAL THEORY OF COORDINATION 178

Abstract 178

Introduction and context 180

1. Literature review 185

2. Theoretical framework 187

2.1 Role theory (RT) 189
2.2 Theory of Relational Coordination (RC) 192
2.3 RT and RC combined 194

3. Methodology 195

3.1 Semi-structured interviews with CAE and SM 196
3.2 Data analysis process 197

4. Results 198

4.1 Organizational factors (RT, factor O) 198
4.1.1 Organizational factors, top half 200
4.1.2 Organizational factors, bottom half 203
4.2 Personality factors (RT, factor P) 203
4.2.1 Personality factors, top half 204
4.2.2 Personality factors, bottom half 207
4.3 Interpersonal factors (RT, factor I) 208
4.3.1 Relational coordination, top half 209
4.3.2 Relational coordination, bottom half 218

5. Limitations of the study 225

6. Conclusions and avenues for further research 225

Appendix 231

Appendix A: Relationship between the supervisory board, the management board and internal audit in Germany 232

Appendix B: Interview guide Head of Internal Audit (CAE) 233

Appendix C: Interview guide Senior Management (SM) 235

Appendix D: Comprehensive interview data 237

References 244

GENERAL CONCLUSIONS 252

LIST OF TABLES AND FIGURES

Page

INTRODUCTION

Figure 1: The Little Prince's drawing number one....2
Figure 2: The Little Prince's drawing number two....2
Figure 3: Definition 1 of IA effectiveness....4
Figure 4: Definition 2 of IA effectiveness....5
Table 1: Synopsis of the multi-method and multi-perspective research....9
Figure 5: The dissertation consists of five related papers....10

PAPER 1

Figure 1: IA effectiveness, a risk-based concept versus construct....25
Table 1: Isomorphism and IA effectiveness....29
Figure 2: Institutional forces and the role of agency (DiMaggio and Powell 1983; DiMaggio 1988), complemented by own considerations....52

PAPER 2

Table 1: Univariate Statistics (Independent Variables)....81
Table 2: Correlation Matrix....84
Table 3: Binary Logistic Regression Analysis....85

PAPER 3

n/a

PAPER 4

Figure 1: Clustering of IAF characteristics/items....129
Figure 2: Aggregate results of the frequency of scores per quartile....142
Table 1: Fisher's exact Test ($p < 0.05$) and crosstabs of the 14 questions with discriminatory power....144
Table 2: Statistics of demographics confirm firm size impact....149

PAPER 5

Figure 1: Kahn *et al.* (1964), Role Theory (RT).....189
Figure 2: Gittell (2006), Relational Theory of Coordination (RC).....193
Figure 3: Role Theory (RT) and Relational Theory of Coordination (RC) combined.....194
Table 1: Organizational factors.....198
Table 2: Personality factors.....204
Table 3: Interpersonal factors, top group (cases A, D, F, G and H).....209
Table 4: Interpersonal factors, bottom group (cases B, C and E).....218
Figure 4: The pattern of interaction is a key determinant.....223

CONCLUSION

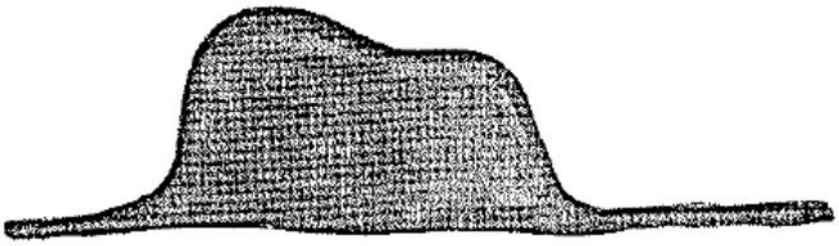
Figure 1: Structure of my dissertation.....252
Figure 2: Definition 3 of IA effectiveness.....257
Figure 3: The Little Prince's drawing number one.....260
Figure 4: Meta-conclusions, part 1.....261
Figure 5: Meta-conclusions, part 2.....267
Figure 6: Summary of my PhD dissertation.....287

GENERAL INTRODUCTION

GENERAL INTRODUCTION

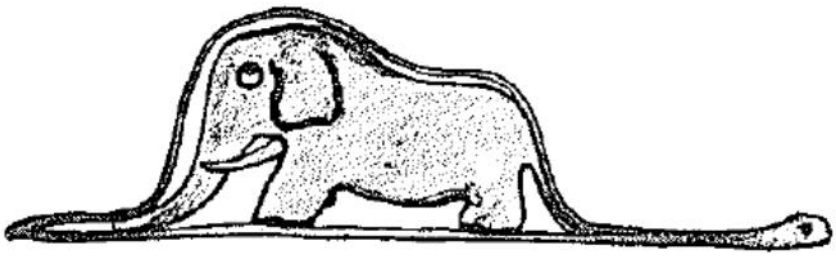
The Little Prince's (de Saint-Exupéry 1943) drawing number one showed a boa constrictor digesting an elephant.

Figure 1: The Little Prince's drawing number one



As the grown-ups confused this with a hat he clarified the *inside* of his masterpiece for them with his drawing number two.

Figure 2: The Little Prince's drawing number two



This dissertation provides *insights* into the effectiveness of Internal Auditing (IA), which is viewed as an underexplored 'black box' in academic research. That subject matter is a sort of 'Elephant in the room', that is, an obvious issue no one or only a few want/s to discuss. This study begins to fill the void by studying the effectiveness of IA.

To guide the informed and uninformed reader on the subject matter of my dissertation I first define what constitutes IA effectiveness and explain the importance of the topic. I reference the gap in academic literature and how this dissertation contributes to knowledge. I disclose my particular motivation to carry out this research before detailing the multi-method and multi-perspective approach chosen in the study to provide fresh insights into this field. At the

end of the general introduction, I briefly discuss each of the five papers[1], how they supplement each other to whet the appetite to appreciate the research outcomes and new agenda of research opportunities in full, which may encourage further studies building on and challenging the findings of my academic work.

What constitutes IA effectiveness?

To start with, there are three components worth looking one by one, i.e., internal, auditing and effectiveness:

INTERNAL

Internal auditors are typically employees of the organization for which they work. There can be arrangements in practice for co-sourcing or even for full outsourcing of IA services.

AUDITING[2]

The Latin word 'audire' means 'to hear' in English. As Ridley (2008, 293) states, *"the right questions will always be the key to effective internal auditing. So will be right listening!"* There is a deeper meaning in the fact that humans have two ears and one mouth (so that we can listen twice as much as we speak).[3] That may be particularly good advice for internal auditors.

EFFECTIVENESS

Ridley (2008, 287) claimed that modern IA has been constructed upon the *"three Es"* of effectiveness, efficiency and economy.[4] Chambers (1992, 22) viewed effectiveness as *"doing the right thing"*, while efficiency means *"doing them well"* and economy means *"doing them cheaply"*.

IA EFFECTIVENESS

There is no straight-forward answer in the literature of what is IA effectiveness but there are

[1] All five papers can be read as stand-alone papers that have their special introduction and conclusion.

[2] Arens *et al.* (2012, 18) define auditing as *"the accumulation and evaluation of evidence about information to determine and report on the degree of correspondence between the information and established criteria."*

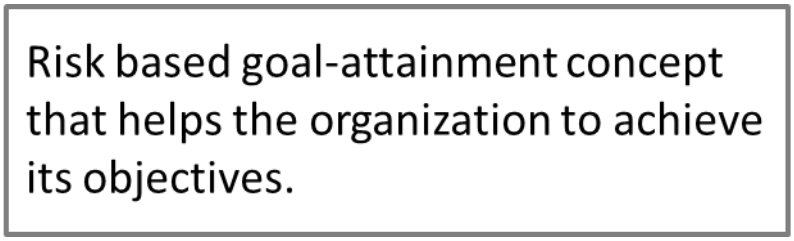
[3] Zeno, Greek philosopher (335 BC - 264 BC), http://www.quotationspage.com/quote/29204.html; accessed on 13 October 2012

[4] Ridley (2008, 288) references more *"Es"* including ethics. Hall (1988) viewed *"unimpeachable integrity"* as *"sine qua non"* of auditing.

some good suggestions I have used. Little help is available on IA effectiveness in the professional standards of the Institute of Internal Auditors (IIA) (IIARF 2011), since these can be considered what Jeppesen (2010, 189) called *"soft texts"*, that is, texts that are non-committal and allow a certain degree of interpretation. However, the IIA demands compliance with its Code of Ethics, which requests that internal auditors *"shall perform internal audit services in accordance with the International Standards for the Professional Practice of Internal Auditing"* and *"shall continually improve their proficiency and the effectiveness and quality of their services"* (IIARF 2011, 7).

This dissertation uses *two* definitions, which will be combined in the general conclusions. Figure 3 summarizes the first definition.

Figure 3: Definition 1 of IA effectiveness



The first definition of IA effectiveness is a contribution of this research, and it builds on Dittenhofer (2001) who regards IA as effective if it is adequate to accomplish its purpose. This definition of IA effectiveness is also inspired by the concept in performance auditing, where effectiveness is considered a 'goal-attainment concept' (ISSAI 3000). To be effective, IA must be linked to the objectives of the organization it supports. Since IA is a service to a business, there is no IA without a business (Chambers 1992). In serving the business, modern IA is risk based (Spira and Page 2003).

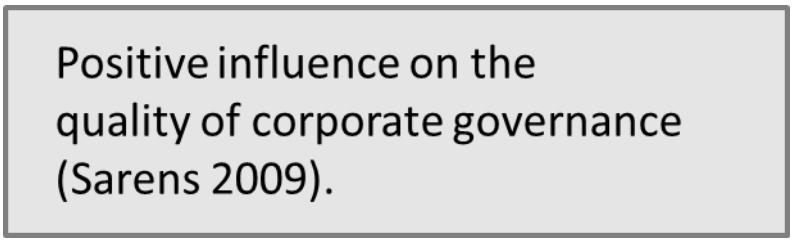
The first definition of IA effectiveness is relatively open to accommodate the plurality (of goals) in practice, thereby not specifying the overarching objective of its contribution as it generally talks about 'goal-attainment'. This is regarded as helpful starting point when investigating the subject matter of IA effectiveness in depth and within its real-life context to learn about what is happening in practice. In doing so, the research remains open to serendipity, and may find something without searching for it, so discover the unexpected.

This dissertation defines IA effectiveness as a 'risk based goal-attainment concept that helps the organization to achieve its objectives' and it argues for a consolidation of IA around its

core function of providing assurance.[5] Providing assurance is a means to an end of helping the organization to achieve its objectives. In doing so, IA is regarded as effective when it contributes to achieve what is intended. An IA service with no assurance content at all would not qualify as effective IA as defined here. With this, I take a position in my dissertation, addressing Anderson's (2003, 120) question: *"Could you have a 'no assurance' internal audit function?"* I acknowledge that there is room for consulting service, as meaningful assurance service typically has a consultative element, as pointing to a problem is important, so is helping to improve.

The second definition of IA effectiveness that is used in this dissertation stems from Sarens (2009), and it more clearly defines what the goal should be when talking about effective IA. Figure 4 summarizes the second definition.

Figure 4: Definition 2 of IA effectiveness



Sarens (2009) explored when we can talk about an effective Internal Audit Function (IAF), postulating that the parameter should be whether the IAF has a 'positive influence on the quality of corporate governance', thereby distinguishing at least two components that merit further investigation: the characteristics of the IAF as a whole and the characteristics of the individual auditor.

This study will address Sarens' (2009) considerations by providing insights about characteristics of the IAF as a whole and the characteristics of the effective Head of IA (CAE)[6] by offering pointers and explanations that can sort the wheat from the chaff. In addition, this dissertation identifies the factors that are associated with IAF's role in corporate governance, noting that there is no universally accepted definition of this important subject

[5] Arens *et al.* (2012, 18) define assurance services as *"an independent professional service that improves the quality of information for decision makers."*
[6] Head of Internal Audit or Chief Audit Executive

matter (Cohen *et al.* 2010, 757).[7]

Why is IA effectiveness an important topic?

Effectiveness is the most important of the three 'Es'. If IA is ineffective, it does not matter how efficiently or economically the service was rendered. When examining the effectiveness of IA we study its fundamentals. This subject matter is relevant and important for the IA profession and its members because beneficial and effective evidence of IA service rendered is one way to be perceived as legitimate in the eyes of major stakeholders, and legitimacy is needed in order for IA to survive as a profession and function within an organization.

The relevance and significance of the subject matter goes much further. The beginning of the twenty-first century has seen large corporate bankruptcies, a prominent and recent example of which being that of Lehmann Brothers (Valukas 2010). Bailouts of entire countries have also occurred, jeopardizing even whole continents. This century promises to become the era of corporate governance (Tricker 2000, 289; Baker and Anderson 2010, 3). The subject matter is particularly important because IA could be a strong pillar of corporate governance, which the IA professional body already claims it to be.

According to Huse (2007, 15), *"Corporate governance is seen as the interactions between various internal and external actors and the board members in directing a firm for value creation."* The IAF and its CAE are part of the group of internal actors, so is Senior Management (SM). The concept of IA effectiveness is prominently positioned in the IIA's definition and actively debated in practice. Evaluating and improving the effectiveness of risk management, control, and governance processes of an organization are the core claim of IA (IIARF 2011).

While the IIA claims that IA is a pillar of corporate governance, some of its key stakeholders question its value. There is some tension between the value IA believes it is rendering and that perceived by some of its customers. For example, in the 2009 Public Company Audit Committee Survey (KPMG 2009), 29 percent of survey respondents, board and audit committee (AC) members, were very satisfied that the AC, the internal auditor, the Chief

[7] The International Standards for the Professional Practice of Internal Auditing (IIARF 2001, 125) define governance: *"the combination of processes and structures implemented by the board to inform, direct, manage, and monitor the activities of the organization toward the achievement of its objectives."* The UK Corporate Governance Code (FRC 2012) defines *"The purpose of corporate governance is to facilitate effective, entrepreneurial and prudent management that can deliver the long-term success of the company."*

Executive Officer (CEO), the Chief Financial Officer (CFO), and other SM had a clear, shared vision of the role of IA at the company. Evidently, in less than a third of cases did board and AC members have full knowledge of IA activities and their value to the organization, while in the large majority of cases, IA activities and the value they provide remained somewhat obscure. Similarly, Beasley *et al.* (2009, 114) *"highlight the often nebulous, informal nature of internal audit oversight by audit committee and management"*.

What is the gap in the academic literature?

In academic research, IA effectiveness has been largely unaddressed. For example, Anderson's questioned (2003, 102 and 123) who the ultimate customer of IA is and how potential trade-offs among conflicting customer demands are to be managed. Hermanson and Rittenberg (2003) questioned who judges the effectiveness of IA and encouraged future research. Arena and Azzone (2007, 110) suggested *"future studies could address the problem of the effectiveness of internal audit units"*.

This dissertation contributes to fill the gap in academic literature on IA effectiveness by offering a definition, and by suggesting factors that enhance or detract from IA effectiveness, thereby also including the stakeholder's perspective.

1. The current IA literature does not provide a clear definition of IA effectiveness. This study uses two definitions, which will be synthesized in the general conclusions.

2. The current literature does not provide studies about factors that influence IA effectiveness and how IA effectiveness can be created and enhanced. In practice, as Soh and Martinov-Bennie (2011) show, the most commonly employed measures of IA effectiveness relate to its *efficiency* with regard to delivery of the annual IAF work plan and the acceptance and adoption of IA recommendations. This dissertation provides meta-conclusions suggesting a framework of macro- and micro-variables, which influence IA effectiveness.

3. The current literature rarely considers the stakeholder's perspective on IA effectiveness. If so, meeting customer expectations is generally regarded to be a meaningful referent in measuring IA effectiveness (Geis 2010, Mihret *et al.* 2010). This multi-method and multi-perspective dissertation includes a multiple-case-study, in which CAEs and SM in the same organization are interviewed to examine and challenge the concept of

'expectation matching'.

What particularly motivated me to research IA effectiveness?

Since my appointment as a CAE in the summer of 2007, I have searched for a path to effectiveness in IAFs. My first budget review as a CAE in the autumn of 2007 clarified the importance of SM's expectations. The ambition to render a valuable service as a CAE, combined with recognition of the importance and challenges of expectations, has been the key motivation for my search to advance the understanding of IA in general and of the effectiveness of IA in particular.

This search has resulted in this dissertation that consists of five related academic papers. While I have been working full-time as CAE, I have accomplished this dissertation in parallel, sort of in my 'night job'. My prime motivation when undertaking academic research was neither *"to publish at all ends"* nor did I originally have any *"research/practice gap"* (Parker *et al.* 2011, 6) on mind. Put simply, after qualifying as a Chartered Internal Auditor in 2009 I still wanted to better understand the world of IA, the world I have been living in since 2007. As *"only practice contains all theory"* (Kappler 1988), my academic studies helped me to reflect on the practice and foundation of IA.

With this venture into the academic world I view myself as a 'border crosser', sort of a 'hybrid', a practitioner and an academic. I consider my research as part of the critical research tradition and also contributing to the 'practice improvement' research tradition. While *"the question of the relevance and impact of audit research to audit practice remains a highly debated matter"* (Leung *et al.* 2011, 82), I hope that my research contributes to *"bring the two worlds together"*, so *"bring academic research to practitioners"*, and is regarded in parts as *"research you can use"* (Parker *et al.* 2011, 8). Being critical towards the status quo in IA, the results may well be used to improve practice.

Multi-method and multi-perspective approach to study IA effectiveness

One of The Little Prince's (de Saint-Exupéry 1943) key message that *"What is essential is invisible to the eye"* particularly applies to IA because auditing is a credence good (Causholli 2009). Audit customers cannot discern the quality of the good even after purchasing and consuming it. Audit quality is not directly observable except in the event of an audit failure. It is relatively easy to see only in hindsight when an audit was not effective (Bender 2006).

This study helps to know a little more what 'good' (that is, comparatively more effective) and 'bad' (that is, comparatively less effective) IA looks like in practice, and not only in hindsight after an audit failure. Given that the subject matter is intangible as IA is a credence good (Causholli 2009) and can mean different things to different people at different times and in different contexts, the study benefits from a multi-method and multi-perspective approach. Table 1 provides an overview of the study approach chosen.

Table 1: Synopsis of the multi-method and multi-perspective research

Paper	Method/type	Perspective/theory
1	Literature review	New-institutional theory and entrepreneurship (DiMaggio and Powell 1983; DiMaggio 1988)
2	Explorative work	CBOK (2006) data from 782 U.S. CAEs
3	Conceptual paper	Critical reflections on the IA profession
4	Empirical survey	Questionnaire data from 46 German CAEs
5	Qualitative research	16 semi-structured interviews with CAEs and Senior Management in the same organization. Applied role theory (Kahn *et al.* 1964) in combination with the theory of relational coordination (Gittell 2006)

This dissertation is based on a literature review on IA effectiveness using new institutional theory and entrepreneurship (DiMaggio and Powell 1983; DiMaggio 1988) as framework. Paper 1 identifies major patterns in the existing literature and provides an agenda for future research on IA effectiveness. The suggested research questions *"What characterizes the comparatively more effective, and value-adding, CAE and IAF?"* are further studied in papers 4 and 5.

Paper 2, the explorative work examines and identifies the variables associated with the IAF's active role in corporate governance (building on definition 2, Sarens 2009) in the United States (U.S.), thereby exploiting the biggest database that is available on IA.

Paper 3, the conceptual reflections on the IA profession provides new knowledge that could explain the IA profession's marginalization in the governance debate on solutions to the financial crisis that started in 2007.

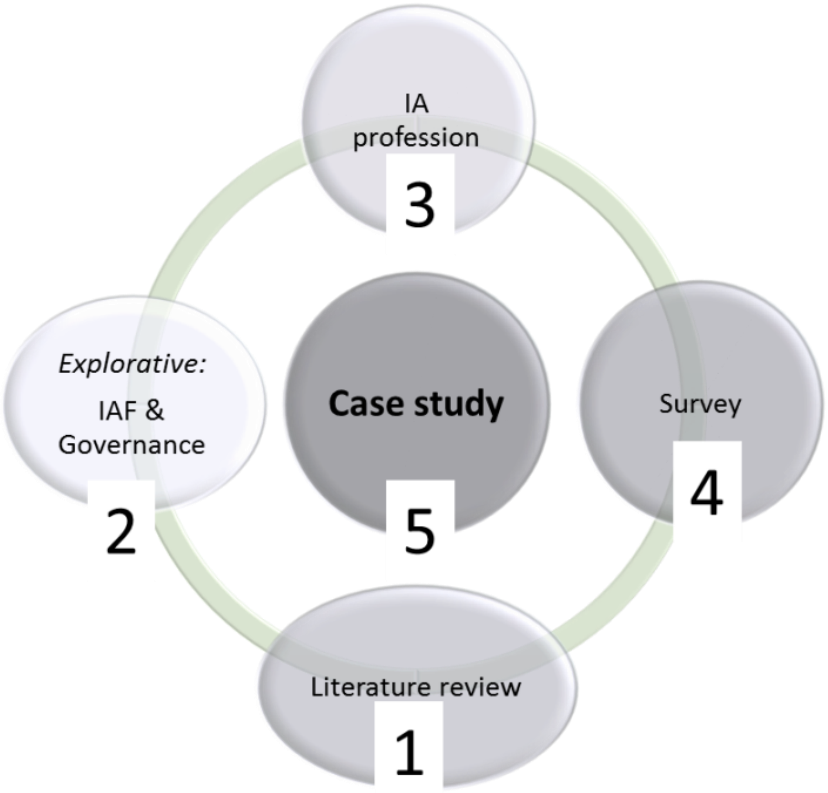
Paper 4, an empirical survey on IA practices based on the self-assessment of CAEs in

Germany provides characteristics suggested by literature that help to differentiate and cluster IAFs into different groups, which may point to different levels of IA effectiveness.

Paper 5, novel qualitative research completes this dissertation by studying IA effectiveness from the perspectives of both the CAE and SM, either the CEOs or the CFO in the respective organization. To do so, 16 semi-structured interviews are conducted in eight organizations in Germany, thereby applying, for the first time, role theory (Kahn *et al.* 1964) in combination with the theory of relational coordination (Gittell 2006) to an IA context.

To conclude the general introduction, I briefly discuss each of the five related papers in more detail.

Figure 5: The dissertation consists of five related papers



Paper 1 presents a literature review that builds on Dittenhofer's (2001) definition of IA effectiveness and complements the work of Gramling *et al*. (2004) by adding perspectives beyond that of external audit (EA). The study introduces and defines IA effectiveness as a risk based goal-attainment concept that helps the organization to achieve its objectives.

This paper examines the empirical literature on IA effectiveness through an 'effectiveness

lens' based on internal auditors' self-assessments and other stakeholders' perspectives that have been published since the latest revision of the IA definition in 1999. It uses the perspectives of new institutional theory and entrepreneurship (DiMaggio and Powell 1983; DiMaggio 1988) as a framework, thereby recognizing the tension between institutional forces and the role of agency.

The three isomorphic forces that influence IA effectiveness, coercive, normative, and mimetic, are reviewed and discussed. The paper explores what happens when three isomorphic forces point in different directions and/or are in conflict with organizational demands.

The study concludes that the CAE may turn to hypocrisy (Brunsson 1986, 1993) or may become an institutional entrepreneur (DiMaggio 1988; Battilana 2009) to resolve the dilemma. CAE agency is suggested as a new field for empirical research. Internal auditors may assume a more proactive role in the governance arena (IA effectiveness definition 2, Sarens 2009). In doing so, the 'stereotypical CAE' may transform from being rather reactive, responding, and seeking to meet others' expectations to being an agent who drives change. This is expected to be a rare phenomenon in practice for it requires particular skills. However, bottom-up agency is possible, which is a good reason to seek it out.

Paper 2 is an explorative work that identifies the variables associated with the IAF's active role in corporate governance. It is the first paper to examine this research issue. This paper is based on the second underlying definition of IA effectiveness that assesses the level of IA effectiveness based on its influence on corporate governance (Sarens 2009).

The responsibilities of IA are defined as helping to evaluate and improve the effectiveness of governance processes. However, the Common Body of Knowledge study (CBOK 2006) indicates that 41.7 percent of the IAFs in the U.S. do not play an active role in corporate governance, and only 6.5 percent of their working time is allocated to governance issues. Based on responses from 782 U.S. CAEs in the CBOK (2006) database, a company with an IAF that has an active role in corporate governance is significantly and positively associated with the use of a risk based audit plan, a quality assurance and improvement program, and an AC's input to the audit plan.

Paper 3 is a conceptual paper that discusses the status of IA as a profession and questions why it has not generally been seen to play a significant role in the financial crisis that started

in 2007, either as part of the problem or as part of the solution. This paper provides new knowledge that may explain the IA profession's marginalization in the governance debate on solutions to the financial crisis, which can help the IIA to establish IA as a full profession.

This paper implicitly builds on both definitions of IA effectiveness. It explores the role of IA in the governance arena (definition 2), and it examines IA effectiveness from the perspective of a 'goal-attainment concept' (definition 1), thereby pointing to structural conflicts of IA when called upon to serve two masters (those primarily responsible for governance and those being governed, the board/AC and SM) and the paper argues for a consolidation of IA around its core function of providing assurance to the board/AC in order to establish IA as a profession in its own right.

This paper may open a new research area in IA that addresses a more critical way of evaluating IA practices.

Paper 4 is an empirical survey that tests whether the IAF characteristics suggested in the literature by practitioners and academic research can differentiate between clusters of IAFs. In this paper IA effectiveness is seen as a risk based goal-attainment concept that helps the organization to achieve its objectives (definition 1).

Using survey data from 46 CAEs in Germany, we can distinguish two significantly different groups of IAFs based on characteristics that made them significantly different. Such differences may indicate IA effectiveness, although this was not explicitly tested. The statistically valid discriminatory characteristics between the different clusters of IAFs include: the existence of an IA charter that is agreed by the board/AC, possible career progression after a tenure in IA, some degree of co-sourcing and outsourcing of IA services, the level of training and professional qualification of IA staff and CAEs, the use of IA technology and risk based IA, whether IA makes recommendations for improving the governance process and rates individual findings and grades the overall report, whether the CAE has appropriate access to the board/AC, whether the CAE benefits from SM's and the board/AC's input to the IA plan, and the CAE's informal contact with SM.

This survey paper also provided access to multiple case studies based on interviews, thereby applying an innovative theoretical lens to the research context of IA.

Paper 5 is a qualitative research paper, in which IA effectiveness is defined as a risk based

goal-attainment concept that helps the organization to achieve its objectives (definition 1) to be open for the plurality (of goals) in practice. This paper addresses IA effectiveness from the perspectives of both the IAF and SM based on rich interview data. This study breaks new ground in applying role theory (Kahn *et al.* 1964) in combination with the theory of relational coordination (Gittell 2006) to the research context of IA effectiveness, thus, providing an original theoretical framework as an unique contribution.

This study is one of only a few with such a research design, and it is the first study in the German context to interview CAEs and SM in the same organization to enhance the body of knowledge on IA effectiveness. Sixteen semi-structured interviews with CAEs and SM in the same organization were conducted which provide insights into the

- Behavioral dimension of IA effectiveness, thereby underlining the importance of interpersonal factors that influence IA effectiveness,
- Concept of customer satisfaction ('expectation matching'), which can easily be misleading,
- Role of the overarching organizational effectiveness, which may help IA effectiveness to flourish or cap its potential contribution and
- Characteristics (and new metaphors) of the effective internal auditor and IAF.

Meta-conclusions and research opportunities

This dissertation offers conceptual considerations of what constitutes IA effectiveness. In addition, this study provides insights into factors that influence IA effectiveness, so the focus of this study is on providing insights into factors that can enhance or detract from IA effectiveness. In doing so, this dissertation helps to illuminate the 'black box' of IA effectiveness based on a multi-method and multi-perspective study.

This dissertation is composed of *multi-method research* comprising a literature review on IA effectiveness, critical reflections on the IA profession, an explorative study and an empirical survey, both based on self-assessments of internal auditors, and qualitative research based on a multiple-case-study, which includes CAEs and SM.

This dissertation offers a *multi-dimensional perspective* on IA effectiveness. Four dimensions

are considered, which includes the

(1) *New-institutional theory* perspective (DiMaggio and Powell 1983; DiMaggio 1988) including the normative force on IA activities/processes (cf. the IIA),

(2) *Organizational* (company) perspective on IA effectiveness, as well as

(3) *Personal* (CAE) and

(4) *Interpersonal* perspective (relational perspective, here: CAE and SM).

This dissertation makes a number of contributions to academia, IA practitioners and the IIA, which are presented in detail throughout the individual papers and are summarized in the general conclusions. The meta-conclusions of this research will lead to a better understanding of the IA world.

However, after studying the phenomena of IA and its effectiveness there were more questions than before. Such questions point to promising future research paths. This dissertation encourages further academic research on the subject of IA and IA effectiveness by providing a fresh agenda for future studies. Questions can be more important than answers: in 2003, research opportunities in IA (Bailey *et al.* 2003) were presented which helped enormously to bring IA forward. Ten years on, this dissertation provides an updated set of research opportunities with the intent to help bringing out the best in IA.

Academic conferences and publications

In November 2010, I benefitted from attending a doctoral seminar in Brussels at the European Institute of Advanced Studies in Management (EIASM) on interpretative research methods. I also learnt a great deal by exposing my work to the academic community, and I have presented papers at several international conferences. I presented paper 1, the literature review, at the 33rd European Accounting Association's annual congress in Istanbul (May 2010), and I presented an enhanced version at a conference for the International Association for Accounting Education and Research (IAAER) in Venice (November 2011). Paper 3, which deals with reflections on the IA profession, was presented at the 9th European Academic Conference on Internal Audit and Corporate Governance in London (April 2011). I presented paper 4, the empirical survey, at the 10th European Academic Conference on Internal Audit and Corporate Governance in Verona (April 2012), and paper 5, the multiple-

case-study research, at the 35th European Accounting Association's annual congress in Ljubljana (May 2012) and at the Canadian Academic Accounting Association's (CAAA) annual conference in Charlottetown, Prince Edward Island (June 2012).

Two of the papers in my dissertation have already been published in international academic journals. Paper 2 was published in the *Journal of Applied Accounting Research* (JAAR 2012) and paper 3 was published in the *Managerial Auditing Journal* (MAJ 2012).

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PAPER 1

IN SEARCH OF A MEASURE OF EFFECTIVENESS FOR INTERNAL AUDIT FUNCTIONS: AN INSTITUTIONAL PERSPECTIVE

Abstract

Purpose – Internal auditing (IA) effectiveness is still viewed, to large extent, as a 'black box' in academic research. Relevant empirical studies based on self-assessments of internal auditors and on other stakeholders' perspectives are reviewed through an 'effectiveness lens'. Major patterns are identified in the existing literature and an agenda for future research on IA effectiveness is suggested.

Design/methodology/approach – The review of empirical literature on IA effectiveness uses the perspective of new institutional theory and entrepreneurship (DiMaggio and Powell 1983, DiMaggio 1988) as framework, thereby recognizing the tension between institutional pressures and the role of agency.

Findings – The concept of IA effectiveness is bound contextually. Institutional forces affect IA effectiveness but cannot fully explain the plurality in practice, as these forces differ in strength, they can diverge, and they can be in conflict. Two theoretical outcomes are possible when isomorphic forces point in different directions and/or are in conflict with organizational demands: organizational hypocrisy and institutional entrepreneurship.

Practical implications – IA effectiveness is defined as a risk based goal-attainment concept that helps the organization to achieve its objectives. The study may encourage internal auditors to consider a more pro-active role. The Institute of Internal Auditors may consider solidifying its value proposition since normative isomorphism emerges as a weak force in driving IA change.

Originality/value – New institutional theory, including the works on institutional entrepreneurship, is a 'source' of inspiration for future research. The development of research questions into the phenomena of IA effectiveness is an original contribution of this paper. Pointing to the possibility of hypocrisy and agency in organizations provides an opportunity for the Head of IA to tailor and advance the role of IA in its specific organizational context.

Keywords - Internal auditing, effectiveness, new institutional theory, institutional entrepreneurship, agency

Paper type – Literature review

1. Introduction

The implied requirement that internal auditing (IA) should be effective (Dittenhofer, 2001, p. 444) deserves more attention in academic research than it has received. In practice, IA effectiveness has been actively debated (e.g., Ernst & Young, 2006, 2008, 2010, 2012; IIA Audit Executive Center, 2009; KPMG, 2009; Deloitte, 2010; PwC, 2009, 2010, 2012), but in academic research, IA effectiveness remains underexplored (e.g., Anderson, 2003; Hermanson and Rittenberg, 2003; Prawitt, 2003; Gramling *et al.* 2004; Arena and Azzone, 2007; Paape, 2008; Sarens, 2009; Cohen and Sayag, 2010).

Prawitt (2003, p. 172), for example, acknowledged that 'managing and staffing an IA function (IAF) is a complex undertaking that remains relatively unexplored by rigorous research'. Paape (2008, p. 37) regarded IA effectiveness as a 'totally unexplored area', while Arena and Azzone (2007, p. 110) suggested 'future studies could address the problem of the effectiveness of internal audit units'. Anderson (2003, pp. 102, 123) questioned who the ultimate customer of IA is and how potential trade-offs among conflicting customer demands are to be managed. Hermanson and Rittenberg (2003) questioned who judges the effectiveness of IA and encouraged future research. Sarens (2009) explored when we can talk about an effective IAF, postulating that the parameter should be whether the IAF has a positive influence on the quality of corporate governance, thereby distinguishing at least two components that merit further investigation: the characteristics of the IAF as a whole and the characteristics of the individual auditor.

Little help is available on IA effectiveness in the professional standards of the Institute of Internal Auditors (IIA) (IIARF, 2011a), since these may be considered what Jeppesen (2010, p. 189) called 'soft texts', that is, texts that are non-committal and allow a certain degree of interpretation. Therefore, IA effectiveness is an enigma, as the 'criteria of effectiveness are opaque' (Power, 1997, p. 10).

The purpose of this paper is to clarify the enigmatic phenomenon of IA effectiveness by reviewing the relevant empirical literature, generally considering publications since the latest revision of the IA definition in 1999, but older references are included if they are of particular relevance. Two streams of empirical literature are reviewed:

the ‘supply-side perspective’, that is, empirical studies based on self-assessments of internal auditors; and the ‘demand-side perspective’, that is, empirical studies based on other stakeholders’ perspectives. The literature is screened through an ‘effectiveness lens’ and categorized from the perspective of new institutional theory, which explains the diffusion of organizational order, to provide an updated overview of the contributions of relevant academic studies to the body of knowledge on IA effectiveness. This paper builds on Dittenhofer’s (2001) definition of IA effectiveness and complements the work of Gramling *et al.* (2004), who examined the literature related to IAF quality largely from the perspective of external auditors and who encouraged investigation into other factors that affect the role of the IAF in corporate governance.

This study has four primary outcomes:

1. Institutional forces affect IA effectiveness but cannot fully explain the plurality in practice, as these forces differ in strength, they can diverge, and they can be in conflict.

2. The concept of IA effectiveness is bound contextually. IA effectiveness is measured against institutionalized objectives, that is, IA effectiveness differs according to the context.

3. IA effectiveness does not operate in isolation: the IAF is not an island, stakeholders exert mimetic force and meeting customer expectations as the referent for IA effectiveness is challenged.

4. Two theoretical outcomes are possible when isomorphic forces point in different directions and/or are in conflict with organizational demands, organizational hypocrisy, and agency: CAE[1] agency may enable local adaptation of conflicting forces (institutional entrepreneurship).

Suggestions for future academic research on IA effectiveness are original contributions of this paper.

[1] The term CAE stands for Chief Auditing Executive, used synonymously with Head of Internal Audit.

Section 2 defines IA effectiveness as a 'risk based goal-attainment concept that helps the organization to achieve its objective'. Section 3 introduces new institutional theory as a framework with which to group the literature, thereby building on DiMaggio and Powell's (1983) isomorphic forces: coercive force, normative force and mimetic force. Section 4 presents literature that views IA effectiveness as coercive isomorphism, while Section 5 points to literature that stresses the effect of normative isomorphism and Section 6 views IA effectiveness as driven by mimetic isomorphism. The patterns in the literature are discussed in Section 7, recognizing the tension between institutional forces and the role of agency (DiMaggio, 1988). Section 8 concludes, summarizes the findings, and suggests questions and perspectives for future research and practice.

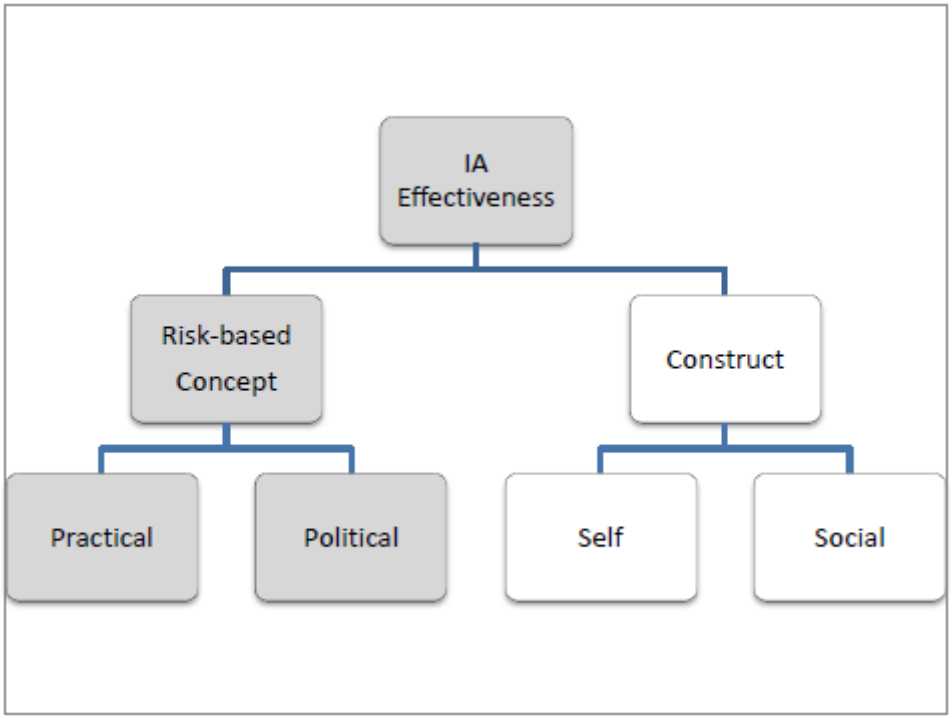
2. Define effectiveness as a 'risk based goal-attainment concept that helps the organization to achieve its objectives'

Effectiveness, particularly IA effectiveness, is not self-explanatory, so it must be defined. Auditing is a credence good (Causholli, 2009), that is, the audit customers cannot discern the quality of the good even after purchasing and consuming it. Therefore, audit quality is not directly observable except in the event of an audit failure; it is relatively easy to see in hindsight when an audit was not effective (Bender, 2006).

When something is 'effective', it is adequate to accomplish its purpose and to ensure 'the achievement of a desired condition' (Dittenhofer, 2001, p. 445). Dittenhofer (2001, p. 450) suggested that the measurement criteria for IA effectiveness ask, 'Did the internal auditor's work result in the correction of deficiencies if deficiencies existed, or if they did not exist, did the internal auditor's work confirm this condition?' This question does not suggest that IA effectiveness equals conformance to the IIA standards or meeting someone's expectations of IA effectiveness; instead, what matters is the practical influence and possible improvement - either the resolution of problems (if there are any) or the (credible) attestation that there are none. This perspective refers to the practical dimension of IA effectiveness that must be acknowledged (Figure 1).

Figure 1

IA effectiveness, a risk-based concept versus construct



We view IA effectiveness as having complementary practical and political dimensions. According to Dittenhofer (2001, p. 450), effective IA helps organizations to achieve their objectives, although Dittenhofer acknowledged the difficulty in determining the appropriate measurement criteria with which to confirm effectiveness. Therefore, IA effectiveness is also a 'political concept', as effectiveness is judged from multiple perspectives, and associated interests are critical. Kanter and Brinkerhoff (1981, pp. 327, 344) observed that 'organizations may have many goals [and that] these goals can be inconsistent, contradictory, or incoherent', while Cameron (1982, p. 9) pointed to the absence of consensual criteria upon which to make judgments of effectiveness.

Ridley (2008, p. 287) claimed that modern IA has been constructed upon the 'three Es' of effectiveness, efficiency and economy. Chambers (1992, p. 22) viewed effectiveness as 'doing the right thing', while efficiency means 'doing them well' and economy means 'doing them cheaply'. Effectiveness is the most important of the three 'Es'. If IA is ineffective, it does not matter how efficiently or economically the

service was rendered. Dittenhofer (2001, p. 450) emphasized that what really matters to an organization is effectiveness, as efficiency in ineffective pursuit is of no benefit at all: the most irrelevant areas can be audited in a highly efficient way. Thus, modern IA is risk based (Spira and Page, 2003); 'a good IA service gets to the heart of the issues facing the organization' (NAO, 2012, p. 5). The IIA Performance Standard 2010 (IIARF, 2011a, p. 26) demands risk-based internal auditing (RBIA), a concept that has been subject to IIA position papers (IIA UK and Ireland, 2005; IIA, 2009). The focus on critical risks and issues, and the importance of RBIA is further supported by the literature (e.g., Allegrini and D'Onza, 2003; Burnaby and Hass, 2009; Ernst & Young, 2012; PwC, 2010).

We find inspiration for exploring the effectiveness concept in performance auditing, where effectiveness is generally considered a 'goal-attainment concept' (ISSAI 3000). This implies that effectiveness is concerned with the relationships among goals or objectives, outputs and outcomes (effects), all of which may often not be straightforward in practice, especially as goals may be vague, conflicting or non-existent (ISSAI 3000). According to Power (1997, p. 115), the distinction between outputs and outcomes is a critical one: we regard the IA report as an output that cannot be effective per se but that may trigger intended change. What matters is that intended change - the (specific) outcome (and possibly lasting effects) that accomplishes the desired improvement (Brombacher 2012, p. 395), along with evidence of causality between the IA report and the achieved objective. Naturally, effectiveness must also be considered in the light of the costs of achieving the goals, and IA has recently been criticized for not providing value for money[2].

The suggested definition of IA effectiveness as a risk-based concept is set apart from IA effectiveness as a construct (Cameron, 1986, p. 8): since the meaning of such an abstraction exists only in the minds of individuals, there would be as many constructs as there were individuals. We do not discuss individual constructs that can entail the notions of deceit and self-deception (Trivers, 2011), or individual constructs that may converge and become social constructs.

[2] The U.K. National Audit Office (NAO) scrutinized public spending and concluded: 'Internal audit ... costs around GBP 70 million a year … however, government does not get value for money from its internal audit service' (NAO, 2012).

We use new institutional theory as a relevant perspective in studying the existing research on IA effectiveness because the theory explains and critically evaluates the diffusion of organizational order: 'DiMaggio and Powell's (1983) useful typology focuses attention on three contrasting mechanisms - coercive, normative, and mimetic - that identify varying forces or motives for adopting new structures and behaviors' (Scott, 2008, p. 133). We apply that typology, as many of its dimensions, including the importance of laws and regulations, compliance with the IA standards (IIARF, 2011a), and the perceived contribution to governance, risk management and control processes by the board of directors (board), audit committee (AC), senior management (SM) and other stakeholders are considered in the IIA's model of value-adding IA (IIARF, 2011b, p. 2). In addition, Arena and Azzone's (2007) survey of 364 Italian companies confirmed the relevance of institutional forces in influencing companies' behaviour regarding IA.

3. Introduction of institutional theory

Institutional theory is founded on the work of Max Weber (1980) on rule and legitimacy, and Scott (2008, p. 151) reported that 'Weber was among the first social theorists to call attention to the central importance of legitimacy in social life'. According to Weber, a ruler may be forced out of office if he or she lacks legitimacy, that is, when he or she lacks support from the people and when the people see a more promising alternative path to satisfying their goals than obedience to the ruler. The same logic applies to institutions[3] and organizations, in general, and to IA, in particular. Legitimacy is needed in order to survive, and providing evidence of added value and effectiveness is one way to be perceived as legitimate in the eyes of major stakeholders. Providing such evidence is not an easy task for internal auditors, as they are not connected directly to the profit and loss account. The value of support functions, as they are often called in practice, is difficult to assess since meaningful measurement criteria are typically of a qualitative, rather than a quantitative, nature (Nobel, 2010).

The conceptual framework provided by the IIA Research Foundation (IIARF, 2011b,

[3] See Scott's (2008, p. 48) conception of institutions: 'Institutions are comprised of regulative, normative and cultural-cognitive elements that, together with associated activities and resources, provide stability and meaning to social life'.

p. 2) posits that many factors affect the value of IA, while the determinants of IA value are IA's contribution to governance, risk management, and control processes, as they are perceived by the board/AC, SM and other stakeholders. Key factors of such determinants include laws and regulations, corporate governance structures and the AC, compliance with the IA standards, organizational characteristics, characteristics of the individual internal auditor and the CAE. These factors correspond to some extent with the features of institutional theory, which some scholars have applied as a theoretical framework in the context of IA (e.g., Al-Twaijry *et al.*, 2003; Arena *et al.*, 2006; Arena and Azzone, 2007; Arena and Jeppesen, 2012). When DiMaggio and Powell (1983, pp. 147, 150) studied 'what makes organizations so similar', they observed that 'rational actors make their organizations increasingly similar as they try to change them'. Such actors respond similarly to three mechanisms - coercive forces, normative forces, and mimetic forces - causing what DiMaggio and Powell called 'institutional isomorphic change'. In the context of IA, these three forces demand compliance with laws and regulations, adherence to the professional practices as promulgated by the IIA (IIARF, 2011a) and prescriptions from consulting firms, and imitation of other IAFs by learning from and mimicking others' (best) practices.

We use the three institutional forces of coercive isomorphism, normative isomorphism and mimetic isomorphism as major dimensions in reviewing the relevant empirical studies through an 'effectiveness lens', building on the early scholarly work of DiMaggio and Powell (1983). The next three sections on isomorphism are modelled similarly: we start with expectations, that is, what we should expect to see in relation to IA effectiveness, followed by what we find in the present body of literature and, finally, a brief summary of what do we know and what needs further research.

The paper groups the literature according to three institutional forces as summarized in Table 1.

Table 1

Isomorphism and IA effectiveness

Isomorphism and IA effectiveness	Coercive force	Normative force	Mimetic force
What can we expect to find in the literature?	IA is effective when it complies with laws and other binding regulations.	IA is expected to be effective if it develops a distinct professional identity and adheres to the standards for professional performance. The stronger the normative force of the IIA the more effective the IAF.	IA is effective when there is a legitimate, institutionalized model on which to base IA.
What does the literature tell us?	Companies and IAFs seek to conform to laws to secure their legitimacy. Especially in less developed markets in terms of maturity of corporate governance, coercive force is recommended to increase the value that IA can add.	The IA identity is not clear (enough). There is lack of exclusivity. There is non-compliance in practice with the professional standards of the IIA, promulgating the way IA should look like.	Meeting customer expectations serves as useful referent of IA effectiveness. There are multiple customers and stakeholders of IA, including the board/AC, SM and external audit (EA).
What can we know?	If having an IAF is legally required, organizations have an IAF.	The role and influence of the CAE is critical.	There are multiple stakeholders who may have different expectations of IA's value proposition. EA view IA as auxiliary to what EA is tasked to do, that is auditing the financial statements.
What needs to be researched?	Having an IAF does not necessarily mean that the IAF is effective. Effective IA is not the same as value-adding IA; IAFs can be effective in non-value adding pursuit. The influence of organizational culture when responding to coercive forces. The influence of coercive force in less developed corporate governance contexts, e.g., Saudi Arabia and	Better understand the necessary competence of internal auditors in general, and of the CAE in particular. Study the contextual dependency of IA effectiveness by considering the influence of organizational characteristics (politics, culture). Study moments of discomfort and conflict, when the normative guidance and organizational specifics disagree. Study the influence of IIA standards as "soft text"	Seeking to meet expectations entails challenges for IA, especially when expectations differ, when they are vague, or do not exist at all. Where do expectations come from, what affects them, how do they evolve, and what can IA do to influence them? Why is attention to IA and support from the board/AC and SM sometimes lacking? The EA perspective, where IA quality is perceived as higher when it has greater

Isomorphism and IA effectiveness	Coercive force	Normative force	Mimetic force
	Sudan. Can IA effectiveness be legally requested, or is it rather a matter of "gardening"? Is IA generally more effective in an environment that legally requires organizations to have an IAF (e.g., in comparison to environments where the comply-or-explain principle is applied)?	versus "hard text". In addition, research pros and cons of setting IIA standards as descriptive codification of practice or as progressive normative standard.	utilitarian benefit for EA, can be challenged. The three criteria (objectivity, performance and competence) are assessed based on observable indicators that can be disputed.
Literature, e.g.:	Brierley et al. (2001), Al-Twaijry et al. (2003), Arena et al. (2006), Carcello et al. (2005a, 2005b), IIARF (2007), Hermanson et al. (2008), PwC (2009), IIARF (2009), Lin et al. (2011), Marks (2012)	Abbott (1988), Burns et al. (1994), Ridley and D'Silva (1997), O'Regan (2001), Spira and Page (2003), Van Peursem (2004, 2005), IIARF (2007), Abdolmohammadi (2009), Mark and Taylor (2009), Arena and Jeppesen (2010), IIARF (2010), IIARF (2011a, c), Lenz and Sarens (2012)	Albrecht et al. (1988), Rezaee and Lander (1993), Cooper et al. (1994), Scarbrough et al. (1998), Felix et al. (2001, 2005), Goodwin and Yeo (2001), O'Regan (2001), Raghunandan et al. (2001), Krishnamoorthy (2002), Goodwin (2003), Gramling et al. (2004), Sarens and DeBeelde (2006a, 2006b), Mihret and Yismaw (2007), Rose and Norman (2008), Anderson (2009), Arena and Azzone (2009a, 2009b), Christopher et al. (2009), Davies (2009), Halimah et al. (2009), Sarens et al. (2009), Cohen and Sayag (2010), Geis (2010), Hoos and D'Arcy (2010), Norman et al. (2010), De Zwaan et al. (2011)

We first discuss coercive isomorphism as an institutional force that may serve to open the door for IA, as in the Italian case, where regulations have a strong influence on the development of IA (Arena *et al.*, 2006).

4. Coercive isomorphism

Organizations are often forced to adapt to the cultural expectations of their surroundings to gain legitimacy, a process which DiMaggio and Powell (1983) termed 'coercive isomorphism'. As cultural expectations become more homogeneous, the same is expected of organizations. Cultural expectations frequently manifest themselves in the form of regulation; therefore from this perspective, the measure of

IA effectiveness is primarily associated with compliance with laws and other binding regulations. Thus, IA may be considered legitimate and effective if it complies with society's expectations in the form of regulation.

In a multiple case study in Italy, Arena *et al.* (2006, p. 288) underpinned the power of legislative forces, confirming coercive isomorphism and observing that 'companies are subject to rules and regulations to which they tend to conform so as to ensure their legitimacy'. That phenomenon is stronger when regulations impose sanctions, as in the case of Italian companies listed on the New York Stock Exchange (NYSE), which requires that all listed companies have an IAF. Similarly, Arena and Jeppesen (2012) regard coercive forces as the most powerful force in triggering change.

While the NYSE listing rules mandate the presence of an IAF (NYSE Section 303A.07)[4], the size and nature of that function are not specified, and the NYSE does not address its effectiveness (Carcello *et al.*, 2005a), perhaps, because the regulator has no clear perspective on what IA effectiveness means, what its determinants are or what it looks like. Still, Carcello *et al.* (2005a) regarded coercive force as an important driver of change, such as in the case of the NYSE requirements that heighten efforts to force compliance with the Sarbanes-Oxley Act (SOX) from 2002. Carcello *et al.* (2005b, p. 124) 'find that IA budgets, staffing levels, meetings with the AC, and meeting length increased markedly from 2001 to 2002'.

Hermanson *et al.* (2008) systematically reviewed IA-related problems revealed in SOX Section 404 reports and offered specific recommendations for building an effective and value-adding IAF. Although the authors did not provide a definition of IA effectiveness, they interpreted as a sign of effectiveness the absence from SOX Section 404 of material weaknesses caused by IA-related problems. The study by Lin *et al.* (2011, p. 288) linked IAF attributes and activities with an observable outcome-based measure of IA effectiveness, that is, the disclosure of SOX Section 404 material internal control weaknesses, and stated that it 'lends support to the requirement that NYSE-listed companies maintain an IAF'. Lin *et al.* (2011) showed, among other

[4] See Audit Committee Additional Requirements, 303A.07 Section (c): 'Each listed company must have an internal audit function.' This site was accessed on 20 March 2012, available at http://nysemanual.nyse.com/LCMTools/TOCChapter.asp?manual=/lcm/sections/lcm-sections/chp_1_4/default.asp&selectedNode=chp_1_4_3

findings, that the effectiveness of EA's SOX Section 404 procedures can be enhanced by cooperating with a firm's IAF. In addition, various IA activities help IA effectiveness, including the use of quality assurance techniques, grading IA reports and performing follow-up on issues securing remediation.

The board/AC and SM have been primarily concerned with compliance with SOX in the aftermath of the bankruptcy of WorldCom and Enron in 2002-2003. SOX in the U.S. placed particular focus on financial reporting and its associated controls, and absorbed up to 70% of the IAF capacity in the U.S. in 2004, gradually declining to about 20% by 2008 (IIARF, 2009). IA has made a difference when it has been effective in contributing to minimizing or even completely avoiding material weaknesses in the internal control system, with financial reporting being the prime area of interest.

Marks (2012) warned that the narrow focus on SOX might undermine the effectiveness of IA, as resources may be cut back on audits of other risk areas. That may be less of a concern nowadays, as firms may use a risk-based approach to Section 404 compliance (Lin *et al.*, 2011, p. 319; Marks, 2012, p. 44). PwC's survey (2009) demonstrated that only 13% of respondents spent 25% or more of their resources on strategic and business risks, while these two risk areas are the prime causes of value destruction (60%), followed by operational problems (20%), and only 15% stem from financial risks and a mere 5% from compliance-related risks. As compliance ranks first in practice (IIARF, 2007), it becomes evident that IAFs tend to allocate time and resources poorly, and often seem to examine the wrong issues, exerting too much effort towards auditing financial reporting and compliance controls at the expenses of more critical and relevant strategic, business and operational audit subjects.

The European Union's 8th Directive (2006/43/EC, Article 41), called by some 'the European SOX', requires that each public-interest entity in the European Union have an AC, tasked to 'monitor the effectiveness of the company's internal control, internal audit where applicable, and risk management systems'[5]. An IAF is not mandatory in the European Union, so labelling the 8th Directive 'the European SOX' is misleading.

[5] See Article 41, paragraph 2, section (b) accessed 20 March 2012, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:157:0087:0087:EN:PDF

There is only limited and indirect coercive force to have an IAF because someone needs to carry out the monitoring work, and that can be the IAF. However, an IAF is not required by law, and there is no reference to effective IAF.

The regulation of the role of IA in practice is an important factor to create a profession with a distinct identity, as Arena and Jeppesen (2010, p. 112) showed in the case of Denmark, where the external audit (EA) profession controls the IA knowledge base, and 'external auditors succeeded in monopolizing the educational system for internal auditors.' To establish IA in less mature economies, some scholars have suggested adapting coercive force to gain legitimacy. Brierley *et al.* (2001, p. 73) observed in the Sudanese public sector that 'the typical internal audit department is engaged in largely the routine authorization of transactions, is staffed by inexperienced and untrained personnel, and has insufficient credibility, independence or authority'. El-Sayed Ebaid (2011) studied listed firms in Egypt and concluded that IA has not been recognized as a specialized profession. Al-Twaijry *et al.* (2003) assessed IA in Saudi Arabia as immature, non-existent in some organizations, and capable of making only limited contributions when it does exist. SM and auditees in Saudi Arabian organizations are reported to have little respect for IA and internal auditors. While Al-Twaijry *et al.* (2003) acknowledged the relevance of normative forces when establishing local chapters of the IIA, they suggested that IA in Saudi Arabia could be improved if the state played a more coercive role by demanding that organizations establish IA departments.

In summary, the literature indicates that companies and IAF's seek to conform to laws to secure their legitimacy. Coercive forces affect organizations to different degrees. If having an IAF is legally required, organizations have an IAF, but having an IAF says nothing about its effectiveness. We find that there is limited knowledge about what causes regulators to care about regulating IA. While regulators in some cases demand that firms have an IAF, regulators seldom specify what they consider effective IA. This is of interest, because the empirical literature often refers to coercive forces as drivers of change. Especially in markets that are less developed in terms of the maturity of their corporate governance, coercive force is recommended as a path through with to break the prevailing pattern and increase the value that IA can add. In these cases, regulation-demanding IA without specifying its effectiveness may be a

vehicle for professionalizing the IAF. However, in most cases, regulators seem to care little about regulating IA, perhaps because caring would require understanding the IA role. The value proposition of IA, and its role and contribution, may not be clear enough to the regulators.

Next, we will discuss normative isomorphism as institutional force, since the IIA is often considered a source of normative power. According to O'Regan (2001, p. 215), 'the IIA has been the driving force behind the increasing professionalization of internal auditing over the last half-century'.

5. Normative isomorphism

Normative isomorphism explains the diffusion of social order by referring to the professionals who span these organizations. Their professional identity determines their behaviour and explains why their organizations become similar. From this perspective, IA is considered effective if its professional identity makes it comply with its common body of knowledge, its authoritative guidance, and the international professional practices framework provided by the IIA (IIARF, 2011a), the standard-setting body of the IA profession globally. It is expected that, the stronger the normative force of the IIA, the more effective the IAF may demonstrate itself to be by complying with IIA regulation.

Normative isomorphism assumes that IA has a distinct professional identity. However, there are doubts about this in light of non-compliance with the normative guidance in practice (signalling the absence of normative isomorphism), inter- and especially intra-professional competition and the internal auditor's 'enigmatic role' (Van Peursem, 2005, p. 510).

In a postal research questionnaire survey in the UK, Ridley and D'Silva (1997, p. 19) found that complying with the IIA professional standards is an important contributor to IA units' quality of service, as 'professional standards are an essential guide for ensuring that internal audit adds value through the service it provides'. However, Spira and Page (2003) referred to a gap in the rhetoric, in which the standard-bearers for IA proclaim a vision of IA, whereas the practice in organizations may be substantially different: The normative guidance provided by the IIA has been implemented in practice only partially. For example, compliance scores are lowest for

Attribute Standard (AS) 1300 (quality assurance and improvement program) and Performance Standard (PS) 2600 (resolution of management's acceptance of risk), with little more than a third of CAEs claiming full compliance with AS 1300 and half of CAEs claiming full compliance with PS 2600 (IIARF, 2010, p. 65). The failure to comply with AS 1300 is ironic because it is contradictory to the power of review and assurance that is assumed. About half of the IAF represented in the Common Body of Knowledge (CBOK) studies have stated that they do not play an important role in governance and risk management, which contradicts what the IA definition prescribes. According to CBOK 2006, about a third of internal auditors had no role in risk management, and half had no role in corporate governance (IIARF, 2007, p. 55). According to CBOK 2010, only 57% of IAFs performed audits of enterprise risk management processes, and 45% performed corporate governance reviews (IIARF, 2010, pp. 24-25). Therefore, the ample guidance the IIA provides on risk management (e.g., IIA UK and Ireland, 2005 and IIA, 2009) and organizational governance (e.g., IIA, 2006) is widely ignored in practice, and there is a significant difference between what the IA definition claims IAF should do and what the IAF delivers in practice.

The lack of compliance of IA practices with the normative guidance may signal a lack of professional identity. That finding supports the work of Burns *et al.* (1994, p. 86), who do not regard IA as a 'genuine profession', as that would require the requisite authority to enforce its standards in practice. According to Burns *et al.* (1994), IA lacks sufficient intimidative power to gain the professional status of 'genuine' professions, such as medicine, law, and public accounting. Burns *et al.* (1994, p. 92) suggested that many more internal auditors are intimidated by SM than vice versa. As a litmus test, Burns *et al.* (1994, p. 93) suggested that IA test its power by threatening to withdraw or withhold future services, and 'management could effectively respond to the IAF's threats of resignation, withdrawal or suspension of future services by simply replacing its professional IA staff with more cooperative employees who were neither CIAs nor member of the IIA'.

The work of Burns *et al.* (1994) and Abbott (1988) may prove useful in efforts to advance the status of IA as a profession and extend the appreciation and compliance with its professional claims. In searching IA's 'heartland' (Abbott, 1988, p. 71), Burns *et al.* (1994, p. 112) alerted us to the concept that IA may be a 'jack of all

trades' and 'master of none' and that 'mastery over no discipline turns out to be the antitheses of a profession'. According to Abbott (1988, pp. 52, 103), creating and maintaining a professional jurisdiction is a balancing act, as there may be trade-offs between full clarity of purpose and a vague conception (easy target versus good defense), and between too little and too much content (not worth professionalizing versus impossible to legitimize). In addition, Abbott (1988, p. 50) acknowledged that each profession typically has certain well-recognized problems for which it knows it lacks effective solutions.

Arena and Jeppesen (2010) have suggested that IA should identify its distinct role more clearly than is presently the case to increase its chances of being recognized and acknowledged as a profession. The IIA may consider hardening its definition in order to provide the opportunity for more homogeneity in practice (at the expense of increasing exposure to criticism).

Uncertainty about the chief stakeholder of IA and the ambiguity of rendering assurance and consulting services may hurt the legitimacy and status of the IA profession (Lenz and Sarens, 2012). Van Peursem (2004, p. 378) referenced the internal auditor's 'role dilemma' and 'role confusion', and she acknowledged, for example, the difficulties of internal auditors to strike the balance between being independent from operations and, at the same time, providing added value and benefit to operations, and 'be[ing] both watchdog and consultant' can be challenging (Van Peursem, 2005, p. 491). Similarly, the stakeholder's expectations and perceptions survey (IIARF, 2011c, p. 14) stated that 'IA is, by its very nature, a schizophrenic, management function. On one hand, it needs to be completely integrated and knowledgeable. But it also needs a measure of independence required of all auditors. Therefore, IA has a built in cognitive disconnect.'

In addition, there is inter- and intra-professional competition. Van Peursem (2004, p. 379) concluded that 'characteristics of a "true" profession exist but do not dominate'. In the New Zealand example, professional status is formed through membership of the Institute of Chartered Accountants of New Zealand (ICANZ) rather than through membership in the IIA (and/or ISACA). Therefore, IA is subject to normative isomorphism beyond the impetus of the (possibly emerging) IA profession. We must consider normative isomorphism beyond the IA profession, such as from the

perspective of the EA profession. Marks and Taylor (2009, p. 1) questioned whether IA is 'one profession, two, or even more?' since there is intra-professional competition with two dominant organizations for internal auditors co-existing, the IIA and ISACA (formerly the Information Systems Audit and Control Association)[6].

Summing up, normative isomorphism suggests basing the measurement of IA effectiveness on the existence of a distinct professional identity in which compliance with the IIA standards is central. However, normative guidance has been implemented globally only in part and to various degrees, signalling the lack of a distinct professional IA identity. That is further supported by the lack of compliance with IIA standards, in particular with AS 1300 (quality assurance and improvement program). The IIA and IAFs have no power to force compliance. Therefore, IA cannot be regarded as having a distinct professional identity. IA lacks exclusivity and uniqueness in its work or in Abbott's (1988) terms, a distinct 'jurisdiction' over which it has control. Abbott (1988, p. 71) called this jurisdiction the 'heartland of work' that, when fully developed, is 'the characteristic of a profession over which it has complete and legally established control'. Without a distinct professional identity and a corresponding jurisdiction, normative isomorphism is not going to play a role in driving IA change.

Next, we discuss mimetic isomorphism as the third and final institutional force, as imitating others' IA practices may be a way to create an IAF that is considered effective.

6. Mimetic isomorphism

According to DiMaggio and Powell (1983), an organization that is uncertain about the surrounding world's expectations tends to model itself after similar types of organizations that are considered successful and legitimate by their surroundings. The process is known as 'mimetic isomorphism', and in this perspective, IA may be considered effective when there is a legitimate, institutionalized model on which to base it. For example, if a market leader applies a particular type of corporate

[6] The IIA Inc. in the U.S. grants the CIA designation: CIA stands for 'Certified Internal Auditor', 'the only globally accepted certification for internal auditors', see www.global.theiia.org, accessed 5 July 2012. ISACA grants the CISA designation, i.e., Certified Information Systems Auditor. ISACA claims 'CISA is to Audit what CPA and CA are to Accounting'; see www.isaca.org, accessed on 5 July 2012.

governance and runs the IAF in a certain manner, other companies may choose to mimic that model.

We searched the literature for cases on direct mimetic isomorphism in IA, but were unsuccessful.

Albrecht *et al.* (1988, p. 3) expected that the roles of IA could be grouped into types of audit performed - financial, compliance, and performance auditing – and assumed that highly effective IAFs concentrate their efforts on either operational or performance audits because these benefit the company most, but these views have proved to be in error. Instead, matched expectations are the key to IAFs being regarded as effective. Therefore, we acknowledge that it is not the type of audit that matters but that the audit work performed must be consistent with SM's and the board/AC's expectations. Albrecht *et al.* (1988, p. 3) concluded that what matters most is 'that the audit work is completely consistent with the objectives and role as determined by top management and the audit committee'. Flesher and Zanzig (2000) suggested that internal auditors and their customers should have a similar understanding of what makes IA a value-added activity. Gramling *et al.* (2004, p. 239) suggested further research to identify what SM and the board/AC expect from an IAF and what they are currently being provided, a view that is reminiscent of that of Drucker (1985, p. 172), who claimed that 'quality in a product or service is not what the supplier puts in. It is what the customer gets out and is willing to pay for.'

To the extent that these expectations are themselves products of institutions, we place the empirical literature that discusses SM's and the board/AC's expectations into the category of mimetic forces, although indirect. Accordingly, the following sections discuss whether there are institutionalized models regarding the relationships between IA and SM, the board/AC and EA that an IAF may mimic to gain legitimacy and appear effective.

6.1 Is there an institutionalized model of the relationship between IA and SM?

We argue that there is a prevailing institutional model of the relationship between IA and SM that is characterized by vertical relationships that move from the top down. It is a hierarchical relationship, with SM the principal and IA the agent. IA is largely viewed as dependent on SM, but that allocation of power may change when the IAF

has a strong link into the board/AC.

Many academic studies support the critical influence that management support has on IA effectiveness. Albrecht *et al.* (1988, p. 7) viewed the degree of SM support for the IAF as the most critical factor in IA effectiveness. Burns *et al.* (1994, p. 92) observed the risk of internal auditors being intimidated by top management since SM may view IA as a nuisance (Burns *et al.* 1994, p. 103), especially when IA only points out shortcomings without offering ways to remediate and improve. Cooper *et al.* (1994) evidenced a wide chasm between SM and the IAF and pointed to a series of inconsistencies between the audit coverage actually performed by IA departments and its presumed scope from the Chief Executive Officer's (CEO's) point of view. Sarens and DeBeelde (2006a) pointed out that the higher the level of risk-based IA, the higher the status of the IAF. Sarens and DeBeelde (2006b) concluded that the acceptance and appreciation of IA in a company are strongly dependent on the support IA receives from SM. They refer to indicators of such support as, for example: open and direct communication; input to IA planning; approval of resources; response to IA recommendations; and a way to keep IA informed about what is happening in the organization. All of these dimensions - communication, input, support, and caring about IA recommendations and information - are considered indicators of IAF effectiveness.

Mihret and Yismaw (2007), in a study of the Ethiopian public sector, Halimah *et al.* (2009), in a study of the Malaysian public sector, and Cohen and Sayag (2010, p. 304), in a study of the determinants of IA effectiveness in Israeli organizations, pointed out that decisions made by SM affect IA effectiveness, such as in hiring proficient IA staff, developing career channels for IA staff and providing organizational independence for IA work. Geis (2010) identified SM's appreciation of IA as a crucial component of IA effectiveness, and Arena and Azzone (2009a) viewed SM as critical in terms of whether they do or do not implement the IAF's recommendations.

Summing up, a working relationship between IA and SM is very important, and management support is generally viewed as a critical enabler for IA to be effective. Open and direct communication, regular input to IA planning, a shared perspective on risk-based IA, and support of IA recommendations are elements of an institutionalized

model that could provide legitimacy if an IAF were to follow it.

Next, we discuss the institutional model of the relationship between IA and the board/AC.

6.2 Is there an institutionalized model of the relationship between IA and the board/AC?

We argue that there is a prevailing institutional model of the relationship between IA and the board/AC. Along with Adams (1994) and Prawitt (2003, p. 173), we view the internal auditor's role as that of an agent who monitors the actions of another agent (SM), who is employed by the same principal and works in the same organization and for the same owner.

The working relationship between the internal auditor and a company's board/AC has been the subject of academic research for many years. Rezaee and Lander (1993) viewed regular interaction and open dialogue as aiding the IAF's effectiveness. Scarbrough *et al.* (1998) indicated that ACs with only non-executive directors are more likely to establish a symbiotic relationship between the AC and the IAF than are ACs with mixed memberships. Raghunandan *et al.* (2001) and Goodwin (2003) supplemented these views in examinations of the association between AC composition and the AC's interaction with IA, by showing that the independence of the AC and its members' level of finance and accounting experience have a complementary influence on the AC's relationship with IA: ACs with outside and independent directors who have finance and accounting expertise are positively correlated with active oversight, evidenced by longer and more frequent meetings with the CAE and more informal access, both of which makes the AC more likely to review the IA's program and results. Therefore, an intense working relationship between the AC and the IAF is expected to strengthen the independence and objectivity of the IAF (Goodwin and Yeo, 2001). Arena and Azzone (2009b) confirmed that IA effectiveness is positively correlated with intense interactions between IA and the board/AC.

Rose and Norman (2008) and Norman *et al.* (2010) pointed to the potential for unexpected and adverse implications when the CAE reports directly to the AC. That relationship may create threats to IA's independence and objectivity, that stem from

concerns about career and reputation (especially when IA serves as a management training ground), about overreaction of AC members and about retaliation by management. De Zwaan *et al.* (2011) showed that internal auditors are not willing to report a breakdown in risk procedures to the AC when there is a strong IA-AC relationship. That conclusion was a surprise finding in the study since it did not support the original hypothesis.

Anderson (2009) discussed the extent to which IA lacks independence from SM. Abbott *et al.* (2010, p. 23) showed the potential for competing claims on IAF resources between SM and the AC and urged further research on the SM-IAF-AC relationship, as confusion about the chief stakeholder may turn the focus of the IAF away from the best way to address the company's most serious business risks.

Davies (2009) suggested that IA effectiveness depends on whether there is a board/AC that wants the IAF to examine the right things and that supports it doing so or a board/AC that is silent or that impedes the IAF from unearthing its *'skeletons in the cupboard.'*

Summing up, access to the board/AC is a key feature of an institutionalized model that could provide legitimacy if an IAF were to follow it. Regular and timely communication with the oversight body signals shared knowledge and common goals, and appreciation for the work rendered by the IAF. That can give the IAF a strong mandate, and it may strengthen the independence and objectivity of the IAF.

Finally, we discuss the institutional model of the relationship between IA and EA.

6.3 Is there an institutionalized model of the relationship between IA and EA?

External auditors are permitted by the International Auditing and Assurance Standards Board (IAASB) to regard, and rely on, the work of internal auditors. The International Standard on Auditing, ISA 610 ('Using the Work of Internal Auditors') deals with this concept[7]. Richard Chambers (2012, p. 5), president and CEO of IIA Global, alerted internal auditors that 'conversations with the audit committee might prove

[7] See https://www.ifac.org/sites/default/files/publications/files/A047%202012%20IAASB%20Handbook%20ISA%20610%20(Revised).pdf (accessed on 9 August 2012).

difficult at organizations where internal audit is not ready for review'. We argue that there is a prevailing institutional model of the relationship between IA and EA that is characterized by inter-professional coordination and competition, and sometimes by 'subordination'. In the Danish case, EA has succeeded in defining IA as financial auditing, the core remit of EA (Arena and Jeppesen 2010): IA is not recognized as a full profession but as a subordinate profession.

EA is permanently present in the governance arena and has a seat at the governance table, as its service is legally mandated. IA's presence is not so assured, although the CAE 'can earn a seat at the table' (PwC 2012, p. 3). IA is present in that arena to varying degrees and may be marginalized or even ignored.

Abbott (1988, p. 2) found inter-professional competition to be common, as a profession cannot occupy a jurisdiction without either finding it vacant or fighting for it. Arena and Jeppesen (2010) assessed the absence of any dispute over the IA jurisdiction in Denmark, concluding that a settlement had already taken place, but such a settlement may not apply to other contexts, so we argue that there is competition between EA and IA – sometimes direct and sometimes subtle. We refer to the case of India, where the Institute of Chartered Accountants of India (ICAI, 2010) demanded, after the Satyam Computer fraud case, that outsourcing of the IAF be mandatory, basically requesting that IA departments be closed and IA service be rendered exclusively by EA firms. Keizer (2009, p. 49) conceded, 'the internal auditors can function as assistants to the external auditor', and can be helpful in their independent audit of financial statements if internal auditors have the required skills. In addition, in a more subtle form of competition, EA firms have performed and published studies on IA that typically document some degree of key users' disappointment in IA's performance (e.g., Ernst & Young, 2006, 2008, 2010, 2012; Deloitte and the IIA UK and Ireland, 2008; KPMG, 2009; PwC, 2009, 2010, 2012). At the same time, such EA firms offer solutions for improvement as they are also in the business of selling IA services.

While EA in Denmark sees value in positioning IA as a subordinate profession, Arena and Jeppesen (2010) contended that the emancipation of IA from financial auditing in order to identify a distinct role requires more than a change in the definition of IA; clients, regulators and internal auditors themselves have to be convinced, and such a

change also affects the talent pool and its education, training and career patterns. While EA is characterized by clear career paths, IA is often viewed as a stepping-stone to something else (O'Regan, 2001): while 'every profession has typical careers' (Abbott, 1988, p. 129), this is not yet always the case for IA.

Considerable research has assessed IAF effectiveness from the perspective of external auditors, noting that the EA view is uncertain concerning whether IA is a significant player in the governance arena or 'an assistant carrying out the directions of the audit committee and the board' (Cohen *et al.* 2010, p. 780). EA is concerned about the independence of IA and about how threats to independence (Mutchler, 2003) are mitigated, as internal auditors are typically paid by the organization to which they are supposed to render independent assurance and consulting services. Some studies provide evidence that the provision of non-audit services may harm the external auditors' independence, consequently, SOX regulation in the U.S. limited the scope of such services (Ahadiat 2011), however, potential parallels to the world of IA and the simultaneous provision of assurance and consulting services has not yet been fully examined.

The question of IA effectiveness matters to external auditors, as they may have to discuss with the AC the quality of the IAF and the extent to which the AC can rely on IA's work (Cohen *et al.*, 2007). Gramling *et al.*'s (2004) comprehensive study acknowledged that there is uncertainty regarding which criteria are relevant to evaluations of IAF quality. When external auditors determine the reliability of IA's work, they typically use objectivity (reporting relationships), work performance (coverage), and professional competence.

Krishnamoorthy (2002) approximated these criteria using observable values, such as professional certifications and the level to which IA reports to assess competence and objectivity. Other studies applied the same pattern, although observable variables that approximated the three criteria may have differed (e.g., Desai and Desai, 2010). Felix *et al.* (2001, p. 530) showed that, as IA's contribution to the financial statement audit increases, the audit fee decreases. According to Felix *et al.* (2005), client pressure is more important than the perceived quality of IA in determining the extent to which the firm relies on IA. When the IAF is used as a management training ground, EA views IA as less objective (although not as less competent), so higher fees are charged

(Messiers *et al.*, 2011). Christ *et al.* (2012) found that companies that use the IAF as a management training ground experience higher accounting risk. Suspicion of self-review bias leads EA to rely less on work performed by IA when IA has been directly involved in financial system consultancy than when it has not (Munro and Stewart, 2009).

In summary, EA's view of IA quality and effectiveness has been widely addressed, but EA typically views IA as auxiliary to what EA is tasked to do. Studies that take an EA perspective have in common that they discuss IA as a function that contributes to auditing the financial statements. Contributing to the work of EA, that is, in-sourcing parts of the EA activities to save money and/or to make their work easier, and possibly more effective, can be seen as a sign of appreciation and represents an institutionalized model for the IAF to mimic in order to gain legitimacy.

6.4 Are there general institutionalized IA models to mimic?

The mimetic forces can be contextually negotiated and determined among the governance stakeholders. The legitimacy of IA is context dependent, so what provides legitimacy in one context may not in another context: what works well in one organizational context, does not necessarily work well in another. That plurality in practice is acknowledged, as the vast majority of governance frameworks used worldwide are voluntary rather than legislated - that is, they are 'comply or explain' rather than 'comply or else' (King III, 2009, p. 6) – so a 'one size fits all' approach is not viewed as promising because the types of business vary to such a large degree. Therefore, mimicking other IAFs' best practices may not necessarily lead to satisfactory results.

EA pressure is most evidently an isomorphic force, but it may not be the prevailing power. When IA effectiveness is assessed from an EA perspective, IA quality is perceived as better when it has greater utilitarian benefit for EA. Thus, what EA sees in IA is dominated by the reliance question and is isomorphic: the more the work of IA is related to the topics of EA, the more appreciative EA may become. As EA is financially oriented, its focus can be far removed from the areas where IA can make a difference. Modern IA is risk based (Spira and Page, 2003, King III, 2009), which may include finance-related matters, so EA's reliance on IA as an indicator of IA's

effectiveness can be dangerously misleading.

Meeting customer expectations serves as a useful referent of IA effectiveness, but IA has multiple customers and stakeholders in SM, the board/AC and EA, all of which may have different expectations of IA's value proposition. Therefore, meeting customer expectations can be challenging in practice, as these expectations may diverge, they may not be well communicated or well understood, and there may not be a 'chief stakeholder'.

Empirical studies clearly point to the importance of SM and the board/AC, but they are inconclusive concerning whether there is an optimal degree of interaction and concerning which view prevails when IA serves multiple customers. Academia provides no consensus on the best reporting lines for CAE. Beasley *et al.* (2009, p. 114) highlighted 'the often nebulous, informal nature of internal audit oversight by the audit committee and management (i.e., internal audit is overseen by two parties)'. Similarly, Gramling *et al.* (2004, p. 240) suspected tension between the IAF and the board/AC and SM, as they asked, 'if the audit committee and management have different visions for the corporate governance role of the IAF, which vision will dominate?' Gramling *et al.* (2004, p. 240) assumed that the IAF puts one client first but asked, '[on] which side of the line between the audit committee and management does the IAF fall?' Christopher *et al.* (2009) addressed the challenges inherent in IA's trying to 'serve two masters' (IIARF, 2003, p. 3), which the IIA acknowledges creates the potential for conflict, pointing to an optimum that satisfies the needs of both SM and the board/AC. Christopher *et al.* (2009) concluded that the estimation of IAF independence should take into account IAF's relationship with SM and the board/AC together, rather than with each individually. Their findings suggest that the IAF's relationship with the AC is a stronger guarantee of independence than is its relationship with SM and that there may be an optimal degree of intensity (Sarens, 2009) in the relationship with SM: too much or too little involvement and direction can be harmful.

While King III (2009) regarded the board/AC as IA's 'chief stakeholder' of IA responsible for ensuring that there is an effective risk-based IA, the willingness of SM and the board/AC to cooperate with and support the IAF makes a fundamental difference in IA effectiveness. Therefore, it can be hypothesized that IA effectiveness

is, to some degree, a function of board/AC and SM effectiveness. Any CAE (or IA staff member) must be able to reveal and report problems confidently and reliably without being intimidated or fearing termination of their services or employment. It can be hypothesized that the presence of a CAE who is able to address relevant issues and to stand tall when required, along with a governance framework that includes board/AC support and a symbiotic relationship between the two, enables the IAF to unlock its potential.

The patterns in the literature are discussed in Section 7, while Section 8 concludes, summarizes the findings, and suggests perspectives for future research and practice.

7. Discussion

The following discussion builds on the three institutional forces (DiMaggio and Powell, 1983) that provide a helpful categorization of empirical literature on IA effectiveness. Perhaps even more importantly, institutional theory is valued as a 'source' of inspiration for future research.

We first discuss the concept that IA effectiveness, which emerges as contextually dependent, is measured against institutionalized objectives, that is, IA effectiveness differs according to the context.

We then reflect on the three institutional forces - coercive force, normative force and mimetic force - that influence IA effectiveness, but cannot fully explain the plurality in practice, as they differ in level of strength, they can diverge and they can be in conflict. That discussion recognizes the tension between institutional forces and the role of agency (DiMaggio, 1988; Garud *et al.*, 2007; Battilana *et al.*, 2009), and further explores the emergence of CAE agency as a possible answer to conflicting institutional forces.

7.1 IA effectiveness is contextually dependent

Organizational characteristics matter, as a strong corporate governance context is viewed as helpful when establishing a powerful IAF. Gramling *et al.* (2004, p. 237) marked the contextual dependency of IA effectiveness in concluding that 'the relative importance of a quality factor is likely to be contingent on the level of other

organizational characteristics'. As Chambers (1992, p. 24) put it, 'IA is a service to the business and it is essential that the business as a whole determines the sort of internal auditing it shall have'. Cohen and Sayag (2010, p. 305) concluded that the effectiveness of IA depends more on organizational characteristics than on the qualification and work setting of the IA staff. According to Sawyer (1995), the best set of qualities of an internal auditor may be of no avail in the absence of an understanding of the politics and culture of an organization. Chanchani and MacGregor (1999) and Sarens and Abdolmohammadi (2009a, 2009b) pointed to the significance of the politics and culture of an organization.

The legitimacy of IA is context dependent, so there are numerous paths to effectiveness. Some IAFs may meet the highest standards when they contribute to strategic issues in an organization (Melville, 2003). Mercer (2004), Archambeault *et al.* (2008) and Holt and DeZoort (2009) indicate that an IA report can improve investor and other stakeholder confidence when it complements existing corporate governance disclosure. Moreover, having an IAF is a plus in terms of the likelihood that unauthorized acts will be reported, as Kaplan and Schultz (2007) showed. Prawitt *et al.* (2009) attested that IA can play a role in preventing management from aggressively covering up or manipulating earnings or accounts, as IA increases transparency and the likelihood of discovery. In addition, as Coram *et al.* (2008) demonstrated, organizations that have an IAF are more likely to detect and self-report fraud caused by misappropriation of assets than are those that have no IAF.

7.2 Institutional forces can result in increasing IA effectiveness

First, coercive forces are found to be relevant drivers of change in empirical literature, so legislative and regulatory forces are a factor in determining IA effectiveness. In less developed markets, in terms of maturity of corporate governance, coercive force is recommended as a path through which to break the prevailing patterns and increase the value that IA can add.

Coercive forces can be the 'door opener' to establishing an IAF. Legally mandated, clear reporting lines to the board/AC can strengthen IAF's organizational independence and help objectivity. A legal mandate is a very strong mandate, as it is reasonable to assume under normal circumstances that everyone will comply with the

law. The CAE can be encouraged to operate without fear or favour. Coercive force may enable the IAF to be effective; however, it must be doubted that IA effectiveness can be formally created. It will ultimately be an outcome the key stakeholders involved may or may not provide, and we suspect that the informal dimension may play a role in that regard in some places.

Second, normative forces demand that IA develop a distinct professional identity through which institutionalized practices may spread. However, normative isomorphism generally emerges as a weak force in empirical research, most likely because the guidance of the professional body IIA is partly ignored in practice. We understand that IA lacks exclusivity (O'Regan, 2001). IA lacks a jurisdiction, a 'heartland of work' (Abbott, 1988, p. 71), and in some cases, IA may be regarded as a subordinate profession to EA (e.g., Keizer, 2009; Arena and Jeppesen, 2010). That weakness of the professional claim of IA poses a question for the IIA, so the IIA may want to consider ways to enhance the professional identity.

Unifying the various professional bodies, namely IIA and ISACA, may prove advantageous towards actually developing a distinct professional identity: it may provide clear guidance for IA professionals and help in managing the expectations of their stakeholders. Moving towards one combined, authoritative set of standards may increase the share of voice and its weight in the ongoing corporate governance debate, of which the IA profession is not yet a significant part (Lenz and Sarens, 2012). Abdolmohammadi (2009) recommended that the IIA emphasize the certification of membership, as, currently, anyone can sign an IA report, even those with no IA designation.

The third institutional force, mimetic isomorphism, plays an important role in IA effectiveness. We place the empirical literature that discusses the expectations of SM, the board/AC and EA into the category of mimetic forces; as such expectations exert mimetic forces on the CAE to adjust.

The existing research generally assumes that SM and the board/AC have firm expectations and that it is the IA's challenge to meet them. In the case of Sudan (Brierley *et al.*, 2001), IA's limitations become apparent when it is not wanted; although the typical IA unit in Sudan seems to be doing what satisfies the other actors

involved. Such a scenario poses questions about the concept of meeting customer expectations.

IA has difficulty fully living up to expectations (Anderson, 2009) because there can be uncertainty about the value that IA provides. This situation may be partly attributable to the divergent perspectives and expectations of IA's several stakeholders - SM, the board/AC, auditees, and external auditors foremost among them. Therefore, according to Chambers (2008), it is important to 'get the boss right', that is, to define the primacy of the board/AC clearly as the chief stakeholder with oversight responsibilities, as what matters to the board/AC may then matter to SM as well. Chambers (2008) suggested that internal auditors must be independent of SM if the board is to rely on IA to provide the assurance it needs; otherwise, the risk is that IA's reports to the board/AC will be filtered by SM in such a way that only what is palatable to SM is communicated. Investing in these relationships and having a steady and robust dialogue is critical to the IAF's success, given its organizational context.

In cases where the CAE reports to the board/AC, there is an opportunity for members of the oversight body who oversee different organizations to compare and learn from best IA practices. That increases the likelihood that mimetic forces can be applied in a constructive manner.

7.3 Institutional forces may differ in levels of strengths, and they may diverge

Few empirical studies have addressed situations in which institutional forces point in different directions, or what such situations may mean for IA and how the CAE navigates in what may be a paradoxical situation. This is important because our review of the literature shows that the three types of isomorphism may draw IA in different directions or the isomorphic forces may be in conflict with other organizational demands, and that can cause dilemmas for the CAE who is trying to establish an effective IAF.

It is evident, for example, in the Sudanese case study (Brierley *et al.*, 2001) that coercive forces can be in conflict with normative forces. Corporate governance considerations are ignored, as the context is corrupt. IA is not wanted and normative forces are immaterial. That situation represents a particular challenge for CAEs, as institutional forces conflict with what is regarded as good IA practice.

In practice, there may be organizational demands, for example, budget constraints, that affect the delivery of risk-based effective IA. Consider a scenario in which a highly risky subsidiary in an international, possibly remote, location cannot be reviewed and visited on site in line with the audit cycle because of funding limitations.

Another example occurs when there is a bias towards performance, as equity providers and lenders expect returns. Performance may be given clear priority over conformance, a situation in which IA assurance services are down prioritized, and IA support is directed to render cost savings activities or revenue enhancement projects. Therefore, IA may be tasked to perform performance auditing at the expense of more assurance-related types of assignments. Hoos (2010) suggested that internal auditors give priority to either SM or the board/AC. That finding results from an experiment in which the CAE assigned the IA staff to prioritize either the management agenda (cost reduction) or the board/AC agenda (effectiveness).

In addition, little is known about the source of SM's and the board/AC's expectations. An SM with fraudulent considerations (which are not theoretical, as the many corporate scandals show) may be disinclined to benefit from the service that IA can provide. In such cases, it is unclear what the CAE can or should do. This situation again poses questions about the concept of meeting customer expectations.

As organizational contexts differ, a word of caution is appropriate when a company considers mimicking other IAFs' best practices, as doing so may not lead to satisfactory results. Contexts may differ because of organizational specifics, with politics and culture as important factors (Chanchani and MacGregor, 1999; Sarens and Abdolmohammadi, 2009a, 2009b).

What happens when isomorphic forces point in different directions, what that may mean for IA and how the CAE navigates in what may be a paradoxical situation remain central questions. Such paradoxical situations could be more frequent in practice than one might expect. There are two possible reactions to conflicting forces: organizational hypocrisy or institutional entrepreneurship. The following sections discuss these options in relation to IA.

7.4 Organizational hypocrisy may be a solution in practice

'Organizational hypocrisy' may develop when organizations respond to inconsistent norms by systematically creating inconsistencies among talk, decision and action in order to cater to the different expectations (Brunsson, 1986). Brunsson (1986, 1993) showed that organizations that are good at responding to inconsistent demands may live longer, so organizational hypocrisy may serve a useful purpose.

At the professional level, IIA's apparent lack of interest in whether its members comply with its standards may be viewed as an example of such hypocrisy, as are other cases in which IA does not 'walk the talk'. Although such inconsistency between talk and action may be defended by claims that IA standards are in parts voluntary guidance ('strongly recommended guidance'), it qualifies as hypocrisy to the extent inconsistency between talk and action is a deliberate response to inconsistent institutional pressures. We wish to point to that possibility, and we encourage further research to evidence.

Dissonance between rhetoric and practice in IA opens an arena for further studies, building on, for example, the work of Fassin and Buelens (2011) who studied the 'hypocrisy-sincerity continuum in corporate communication and decision making'. Fassin and Buelens (2011, p. 589) noted, for example, 'that in some cases the SM … hypocritically ignore or do not want to know about the dubious practices used to achieve good sales figures'.

However, Fassin and Buelens (2011, p. 591) also pointed out 'that individuals can, indeed, make a difference'. The emergence of institutional entrepreneurship (by the CAE) is another possibility for resolving paradoxical situations, as Arena and Jeppesen (2012) have suggested.

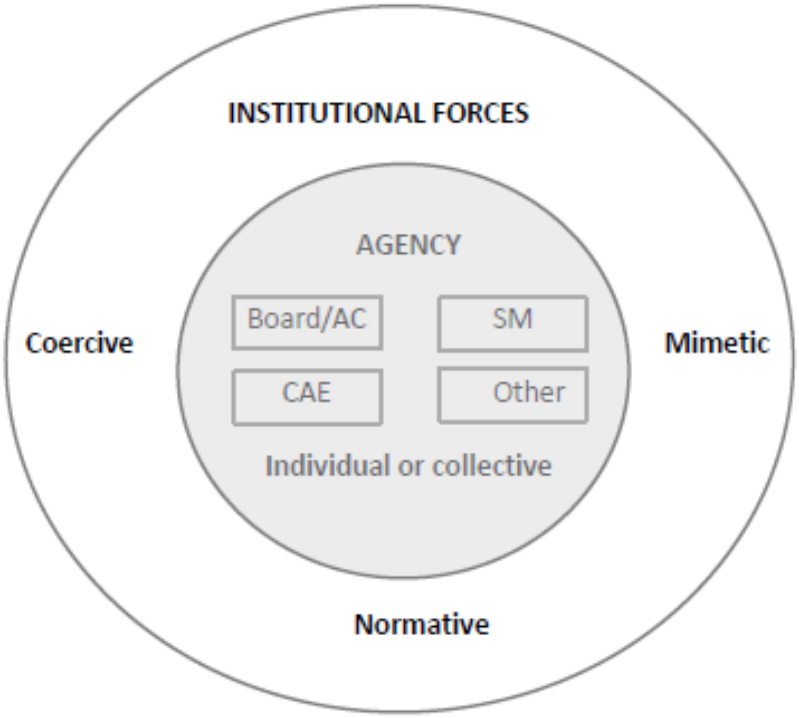
7.5 Institutional entrepreneurship may be a solution in practice

As an alternative to organizational hypocrisy, organizations facing diverging institutional forces may react by developing institutional entrepreneurship capacity. While institutional studies that pursue an 'interest-free model' (DiMaggio, 1988, pp. 4-5) have de-emphasized human agency to the degree humans are viewed almost as robots or puppets (Mouritsen, 1994), neo-institutional theorists recognized early that

human agency sometimes was needed to account for organizational change. In seeking a way to come to terms with the role of interest and agency, DiMaggio (1988, p. 14) introduced the concept of the 'institutional entrepreneur', that is, organized actors with sufficient resources who create new legitimate organizational forms. Figure 2 embeds agency into the concept of institutional theory and refers explicitly to the board/AC, SM, the CAE and any other stakeholders there may be.

Figure 2

Institutional forces and the role of agency (DiMaggio and Powell 1983; DiMaggio 1988), complemented by own considerations



Inspired by Seo & Creed (2002) and Greenwood & Suddaby (2006), the model includes agency to account for cases, where institutional forces are inconsistent with central values or interests in the organization, or where the organization for some reason is not able to adapt to institutional forces, thus forcing central actors such as the CAE to react.

Battilana *et al.* (2009, p. 68) viewed those actors as institutional entrepreneurs (change agents) that '(1) initiate divergent changes; and (2) actively participate in the

implementation of these changes'. To drive institutional change, the change agent may need to develop a compelling vision, mobilize people to support it, and motivate others to achieve and sustain the vision (Battilana *et al.*, 2009, p. 78); particular field characteristics and the actor's social position may be enabling conditions for institutional entrepreneurship (Battilana *et al.*, 2009, p. 87). Battilana *et al.* (2009, pp. 74, 84) viewed field characteristics as characteristics of the environment, or the particular context, and they viewed social capital as being associated with the actor's characteristics, including the actor's informal network and the position to influence others. The integration of interest and agency into institutional theory creates tension between institutional determinism and agency (Battilana *et al.* 2009, p. 68), a 'theoretical puzzle' referred to in the literature as the 'paradox of embedded agency' (Garud *et al.*, 2007, p. 961).

In the perspective of institutional entrepreneurship, the dimension of the CAE's personality, skills, and competencies are viewed as essential factors in IA effectiveness. There are examples of this in the literature. Albrecht *et al.* (1988, p. 6) viewed IA effectiveness as being a result of capable leadership by the incumbent CAE. Pforsich *et al.* (2006, 2008) presented a case study that emphasized the importance of the CAE when setting up the IAF. Van Peursem (2005) regarded communication skills and personal authority as indicators of successful internal auditors who are able to define their roles by adapting and tailoring them to circumstances. Leadership skills are crucial, as communication, listening, and influential skills are required when carrying out fieldwork and liaising with auditees and C-level or board executives (Chambers, 2008). Cahill (2006) presented a case in which IA identified a major issue - the malpractice of interest loading in a bank - but failed to communicate the findings clearly to the AC.

Rittenberg and Anderson (2006) presented the ideal profile of a skilled and qualified CAE, a profile that is exemplified when the CAE, in partnership with SM and the board/AC, works towards improving corporate governance and internal controls. The key performance criteria for CAEs include stature and presence, strategic audit focus, the ability to exercise sound judgment, and the capacity to communicate clearly on audit issues. Mihret *et al.* (2010, p. 240) stressed the crucial skill of being able 'to make the "tough" recommendations without fear or favor'. Similarly, Soh and

Martinov-Bennie (2011, p. 614) emphasized that 'a good CAE is able to work with other stakeholders in the organization and is not afraid to voice his or her opinion even in controversial situations'. The CAE that acts as an institutional entrepreneur must present an IA value proposition that addresses all key stakeholders' expectations and problems. In that context, moments of conflict and discomfort may be highly significant, so they deserve additional attention in empirical research.

The role of the CAE, especially when he or she is interacting with the C-suite (SM) and the oversight body (the board/AC) to foster cooperation, warrants further research, especially as the empirical literature focuses on meeting top-down expectations. In addition, while CAE agency may be a rare phenomenon in practice, bottom-up agency is possible, which is a good reason to seek it out.

8. Conclusion

Using the perspective of new institutional theory (DiMaggio and Powell, 1983; DiMaggio, 1988) as a framework, this paper provided a review of the existing empirical literature on IA effectiveness after the latest revision of the IA definition in 1999. It considered empirical literature that was based on internal self-assessments (mostly by CAEs) and empirical literature that studied how the clients, customers, and beneficiaries of the service rendered by the IAF perceived its value. New institutional theory, including the works on institutional entrepreneurship, is a 'source' of inspiration for future research.

Coercive forces influence IA effectiveness and partly determine what IA effectiveness means in its organizational context. Companies and IAF seek to conform to laws to secure their legitimacy, so if having an IAF is legally required, organizations have an IAF. However, simply having an IAF says little about its effectiveness. Especially in less developed markets (in terms of the maturity of their corporate governance), coercive force is recommended to open the door for IA.

Normative forces influence IA effectiveness to the degree that IA has a professional identity and complies with the norms for professional behaviour, in particular, compliance with the IIA standards. The role and influence of the CAE is critical in that regard, as the CAE is the ambassador of the IA. As the identity of IA is not sufficiently clear, that force is currently comparatively weak, which may pose

challenges to the IIA?

Mimetic forces are exerted by mimicking best practices in other organizations, in particular, the way they meet customer expectations. IA has multiple customers and stakeholders, including the board/AC, SM and EA - all of whom may have differing expectations of IA's value proposition. EA views IA as auxiliary to what EA is tasked to do, that is, auditing the financial statements.

The major conclusions of this paper are summarized below.

Institutional forces - coercive force, normative force and mimetic force - influence IA effectiveness but cannot fully explain the plurality in practice, as they differ in level of strength, can diverge and can be in conflict.

The concept of IA effectiveness is bound contextually, that is, IA effectiveness is measured against institutionalized objectives.

IA effectiveness does not operate in isolation because the IAF is not an island: stakeholders exert mimetic force, and meeting customer expectations as the referent for IA effectiveness is challenged.

When the three isomorphic forces point in different directions, we suggest hypocrisy and institutional entrepreneurship - and possibly CAE agency - as possible theoretical ways to resolve the dilemma.

The remaining part of this section focuses on questions and perspectives for research:

1.) What characterizes the comparatively more effective, and value adding, IAF?

Qualitative research on extreme cases at both ends of the effectiveness continuum - that is, those that are comparatively more effective and those that are comparatively less effective – could lead to relevant, valuable, and novel insights. Such study requires including the perspectives of SM and boards/AC. The question concerning why many stakeholders fail to understand the value of the IAF should be investigated at the firm level without excluding the possibility that, in some cases, there is little or no such value.

2.) What characterizes the comparatively more effective, and value adding, CAE?

There is a need to clarify the necessary competencies of internal auditors, in general, and the CAE, in particular. Researchers should study situations of discomfort in which the CAE makes 'tough' recommendations without fear or favour. Researchers should also study moments of discomfort and conflict that occur when the normative guidance and organizational specifics disagree.

3.) Can the CAE become a change agent, and if so, what are the most favourable conditions for doing so?

Institutional forces have different levels of strength and may not all point in the same direction, or they may be in conflict with the values for which IA stands. In those situations, leadership (agency) is particularly important in setting and driving the agenda. Empirical research has generally viewed agency one-dimensionally: the stereotypical model is that the board/AC and/or SM have expectations that IA tries to identify and meet. That stereotype can be challenged such that, rather than the IA serving its master or masters, the CAE may become a change agent, breaking with institutionalized practices and establishing a new pattern.

CAE agency is suggested as a new field for empirical research, as it is reasonable to assume that driving the agenda from that perspective requires particular skills. Battilana *et al.* (2009, pp. 76, 84) pointed to the importance of 'social capital' (that is associated with actors' informal network) and 'field-level-characteristics'. Research should examine the critical success factors that would enable CAEs to emerge as agents, as personal characteristics and competences such as business acumen and technical skills, leadership skills, communication skills, listening skills, influencing skills and relationship acumen are expected to be important in liaising successfully with auditees, SM and the board/AC.

There are no longitudinal studies on CAE in empirical research, but such research may add new knowledge – or correct extant findings – to that provided by point-in-time research. Individual cases may reveal novelty, while larger-scale analyses and calculated averages may disguise what truly matters. Studies of what moments of change, such as changes to the institutional forces, newly appointed SM or boards/AC, new CAEs or new ownership, mean to the role and value of the IAF are promising. In this way, more may be learned about CAE agency and the CAE's role

as institutional entrepreneur in the context of IA and corporate governance.

1.) Can internal auditors assume a more proactive role in the governance arena?

The more the phenomenon of CAE agency is studied in practice, the more relevant CAEs (and IAFs) and the IA profession may become in the corporate governance arena. Thus, the stereotypical CAE may transform from being an actor in the specific organizational context of governance who seeks to meet others' expectations (and who is sometimes ignored or marginalized in practice) to being an agent who drives change. Bottom-up agency (CAE agency) is expected to be much more difficult to implement than top-down agency, and it may fail when the CAE hits a glass ceiling (or a brick wall) at some point. That perspective is underexamined in practice, and it is ripe for further study that may break the dominant perspective that meeting stakeholders' expectations is the only way an IAF can be effective. New insights from such cases of CAE agency may prove instrumental in enhancing the curricula of IA studies and training, and may be useful in the IIA's efforts to achieve broad recognition of IA as a profession.

2.) Should the IIA solidify its value proposition in order to enhance professionalism, and if so, how?

Researchers should study the influence of IIA standards as 'soft text' versus 'hard text' and the pros and cons of setting IIA standards as a descriptive codification of practice or as a progressive normative standard. Trying to be many things to many people may dilute the value proposition and any appreciation it could enjoy. Serving multiple customers with potentially divergent interests may be disadvantageous to the potential of IA, as the chances of disappointment increase as variances in expectations increase. In addition, reflection on the dual ambitions of IA when it seeks to provide both assurance and consulting services, as claimed in the IA definition (IIARF, 2011a, p. 2), is suggested in order to clarify how that balance is found in practice.

3.) Can IA effectiveness be legally requested, or is it rather a matter of 'gardening'?

Researchers should study the influence of organizational culture when a firm responds to coercive force – such as in less developed corporate governance contexts - as the

suggested route to opening the door to IA. Some organizational cultures may nurture IA, while others may rather ignore or impede it. Even those organizations that operate in the same organizational field may have completely different responses to institutional forces and different agendas/priorities for the IAF (which softens the claimed isomorphic pathway), so the influence of the local context is expected to be important. As 'only practice contains all theory' (Kappler 1988), revelatory case studies that are longitudinal in perspective are encouraged over point-in-time research. Moments of change are an especially promising avenue to clarify what IA effectiveness means in practice and to shed light into the 'black box' of the role and value of the IAF.

4.) Why should the regulator care more about regulating IA?

We question why the state or its regulators should care more about IA and argue that little is known about the regulators' perspective of IA and its effectiveness. Studies in less developed economies, including Egypt, Saudi Arabia and the Sudan, have suggested the state play a more coercive role by encouraging organizations to establish IA departments as a kind of door opener of IA. We acknowledge that driving change may require a strong political will since any change may cause resistance from those who benefit from the status quo. The more we know about IA effectiveness, the more active regulators may become.

5.) Who is the ultimate customer of IA?

The identity of the ultimate customer of IA (Anderson, 2003, p. 102) is still being debated because the literature concerning the best partner for IA's ability to unlock its full potential is inconclusive. This question is ripe for addressing. The literature points to the importance of the board/AC and SM and of meeting their expectations in the CAE's ability to be respected and successful. However, there are many stakeholders, and their expectations are not necessarily congruent. Therefore, meeting expectations is challenging for IA, especially when expectations differ, when they are vague and when they do not exist at all. In addition, we should learn the sources of these entities' expectations and interests, what affects them, how they evolve, and what IA can do to influence them.

6.) Under which conditions can reliance by EA on IA be a helpful indicator of IA

effectiveness, and when can it be dangerously misleading?

Many studies view IA from an EA perspective. The EA perspective, in which IA quality is perceived as better when it has greater utilitarian benefit for EA, can be challenged since EA is financially oriented whereas modern IA is risk based. At present, IA is in some places subordinated under the EA profession, and the inter-professional competition between EA and IA is worth studying from an IA perspective.

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PAPER 2

FACTORS ASSOCIATED WITH THE INTERNAL AUDIT FUNCTION'S ROLE IN CORPORATE GOVERNANCE

Abstract

Purpose: We investigate several variables that are theoretically associated with the internal audit function (IAF) having an active role in corporate governance.

Design/methodology/approach: We use responses from 782 United States (U.S.) Chief Audit Executives (CAEs) in the CBOK (2006) database for our investigation. We make the assumption that an IAF has only one CAE, thus our dataset represents 782 U.S. IAFs.

Findings: We find that an IAF having an active role in corporate governance is significantly and positively associated with the use of a risk-based audit plan, existence of a quality assurance and improvement program, and audit committee input to the audit plan. Control variables such as stock exchange listing, firm size, the existence of an internal control framework, and a CAE with an internal auditing qualification also are positively associated with the IAF having an active role in corporate governance.

Research limitation/implications: A limitation of our study is that CAE perceptions may deviate from actual practice. Also, our sample is limited to the U.S. CAEs who are also IIA members, thus it may not reflect the views of non-members and the CAEs from other countries.

Practical implications: Our results have implications for CAEs who wish to increase the chance for their IAFs to play an active role in corporate governance. The IIA may benefit from our results in its supporting role for the internal auditing profession.

Originality/value: The study is complementary to the literature on the existence and size of the IAF and reveals several avenues for further research.

Keywords: internal audit, corporate governance, audit committee

Classification: Research paper

Data availability: The data used in this study are from the Common Body of

Knowledge in Internal Auditing database (CBOK 2006) that is available from the Institute of Internal Auditors Research Foundation.

Introduction

The primary objective of this paper is to investigate several variables that are suggested in the academic and professional literature to be associated with internal audit functions' (IAF's) active role in corporate governance. This paper does not aim to test theories but wants to provide guidance on strengthening the role of IAF in corporate governance. Prior studies have investigated the factors that are associated with existence (Wallace and Kreutzfeldt, 1991; Carey *et al.*, 2000; Goodwin-Stewart and Kent, 2006) and size (Carcello *et al.*, 2005a; 2005b; Goodwin-Stewart and Kent, 2006; Sarens and Abdolmohammadi, 2011) of the IAF. However, little has been reported on variables that are associated with IAF's active role in corporate governance. We acknowledge that governance issues can mean different things to different people. The Common Body of Knowledge in Internal Auditing database (CBOK 2006) references the IIA Standard 2130 on Governance: *"The internal audit activity should assess and make appropriate recommendations for improving the governance process."*[1] This role has been implicitly assumed (cf., IIA, 2011) but not systematically investigated in prior research.

Krogstad et al. (1999, 29) state that *"bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes"* is a function of the IAF. However, recent data suggest that only 58.3 percent of Chief Audit Executives[2] (CAEs) in the U.S. currently have an active role in corporate governance (CBOK, 2006).

We use CAE data to provide guidance on strengthening the role of IAF in corporate governance. This issue has been brought under question in recent years due to the corporate scandals of the early 2000s. These scandals have raised questions regarding the *raison d'être* of the IAF in organizations (cf. Chambers, 2008; Ernst & Young, 2008; KPMG Audit Committee Institute, 2009; Anderson, 2009). Surveys by Ernst & Young (2008) and PwC (2009) indicate that this situation may be due to insufficient attention to the right issues by IAFs. For example, Ernst & Young (2008) reports that,

[1] In the 2011 revision of the International Standards for the Professional Practice of Internal Auditing (Institute of Internal Auditors 2011), the IIA Standard 2110 on Governance reinforces that demand: "The internal audit activity *must* assess and make appropriate recommendations for improving the governance process."

[2] Head of Internal Audit or Chief Internal Auditor.

many CAEs view strategic risks to be very significant to their organizations, but that few IAFs are actually focused on strategic risks. Similarly, PwC (2009) reports that while strategic, business and operational themes impacting shareholder value are important, IAFs seem to be more focused on financial and compliance activities that may pose much weaker threats to their organizations. As Spira and Page (2003) conclude, this evidence suggests that there is a rhetoric gap between IAFs' *assumed* role and their *actual* role in corporate governance.

We use responses from 782 U.S. CAEs in the CBOK (2006) database for our investigation. We find that IAFs that are perceived to have active roles in corporate governance are significantly and positively associated with the use of a risk-based audit plan, an existence of a quality assurance and improvement program, and input to the audit plan from the audit committee. In our multivariate analysis we find that a number of control variables (e.g., exchange listing, firm size, CAE certification) are also significantly associated with the IAF's active role in corporate governance.

In the next section we describe the literature leading to our hypotheses, followed by a brief discussion of several control variables. The study's research method is presented next, followed by two sections on statistical analysis, and summary, limitations and conclusions from the study.

1. Literature Review and Hypotheses

The internal auditing literature has established that an effective IAF is crucial to the success of a company (Carcello *et al.*, 2005b). Consistent with this message, the New York Stock Exchange (NYSE) requires its listed firms to have an effective IAF. However, the academic literature presents little empirical evidence on the correlates of IAF effectiveness (Lenz and Sarens, 2011a) in various organizations. Based on our review of the literature we identify several variables that are expected to be associated with the IAF having an actual role in corporate governance.

1.1 IIA Standards

The IIA Standards are the professional guidance for internal auditors world-wide (IIA, 2011), and thus IAFs activities should follow the IIA Standards. These Standards delineate basic principles that represent the practice of internal auditing *as it should*

be (IIA, 2011), indicating that these Standards are normative in nature. In this section we identify a number of standards that are crucial for the IAF having a role in corporate governance.

1.1.1 Use of a risk-based audit plan

Standard 2010 (Planning) directs the CAE to *"establish risk-based plans to determine the priorities of the internal audit activities, consistent with the organizational goals"* (IIA, 2011). The concept of risk-based internal auditing (RBIA) has been further subject to position papers (IIA, 2009; IIA UK and Ireland 2005a) complemented by professional guidance when implementing RBIA (IIA UK and Ireland, 2005b). The IIA UK and Ireland (2005b; 5) defines RBIA as *"a methodology that links internal auditing to an organization's overall risk management framework. RBIA allows internal audit to provide assurance to the board that risk management processes are managing risks effectively, in relation to the risk appetite."*

The importance of RBIA is supported by the literature (e.g., Allegrini and D'Onza, 2003; Burnaby and Hass, 2009; PwC, 2009). PwC (2010a) suggests that the IAF should *"focus on critical risks and issues"* and *"align its value proposition with stakeholders' expectations."* Accordingly, IAFs that have risk-based audit activities will place their mission on stronger support for corporate governance stakeholders (e.g., senior management and the board, including the audit committee) than IAFs that do not have risk-based audit methodologies. We propose that risk-based audits will increase the role of the IAF in corporate governance. Thus,

Hypothesis 1: *Use of a risk-based audit plan is significantly and positively associated with the IAF having an active role in corporate governance.*

1.1.2 Quality assurance and improvement program.

Standard 1300 requires that IAFs develop and maintain quality assurance and improvement programs (QAIP) that encompass various aspects of the internal audit activity (IIA, 2011). The concept of QAIP is further detailed by practice advisories helping the CAE to secure conformance with International Professional Practices Framework of the profession, i.e., including the definition, the Standards and the code of ethics, helping to assess the efficiency and effectiveness of the internal audit

activity and to identify opportunities for improvement (IIA, 2011).

Ongoing monitoring and periodic self-assessment are strongly recommended under Standard 1300. External assessments are also recommended at least once every five years by a qualified, independent reviewer or review team. Compliance with this standard may involve the IAF using monitoring tools such as customer (e.g., auditee) satisfaction surveys to assess and change if needed the value-added and relevance of the services rendered. As suggested by Elliot *et al.* (2007), focusing on improving the internal audit process is an important activity that may result in changes to IAFs' role in corporate governance. However, recent surveys suggest that less than one-half of the IAFs conduct customer satisfaction surveys (Ernst & Young, 2008; IIARF, 2009). We hypothesize that compliance with Standard 1300 is positively associated with the IAF's role in corporate governance.

Hypothesis 2: *Having a quality assurance and improvement program in place is significantly and positively associated with the IAF having an active role in corporate governance.*

1.1.3 Input from other Corporate Governance Stakeholders.

Standard 2010 clearly recommends that input from senior management and the board (including the audit committee) must be considered in the audit planning process. The literature suggests that an IAF's role in corporate governance is mainly played via its relationship with other corporate governance stakeholders, such as the audit committee and management (Goodwin, 2003; Ratcliffe, 2009). Raghunandan *et al. (*2001) suggest that the interaction between the audit committee and the IAF, especially when responding to audit findings and avoiding scope restrictions, is significant. We posit that the relationship between the IAF and senior management is a two-way relationship, one that results in enabling and supporting the IAF in its pursuit of an active role in corporate governance (c.f., Sarens and De Beelde, 2006b). Arena and Azzone (2009) suggest that the intensity and significance of the interaction between the IAF and management and the audit committee can be a determinant of IA effectiveness. PwC's (2010b) survey suggests that an IAF's frequent dialogue with executive management and the audit committee helps the IAF clarify and align expectations, and enables the delivery of perceived added value.

These arguments suggest that an IAF's role in corporate governance is positively influenced by its interactions with the audit committee (cf., Rezaee and Lander, 1993; Anderson, R., 2009) and the senior management (cf., Van Gansberghe, 2005; Mihret and Yismaw, 2007; Halimah *et al.*, 2009; Cohen and Sayag, 2010). Thus,

Hypothesis 3: *Input from the audit committee is significantly and positively associated with the IAF having an active role in corporate governance.*

Hypothesis 4: *Input from management is significantly and positively associated with the IAF having an active role in corporate governance.*

1.2 Control Variables

In addition to the test variables identified above, we include a number of control variables in our multivariate analysis. The Basel Committee (2001) requires that as a highly regulated industry, banks and insurance companies must have an IAF. Prior studies report that banks and insurance companies have more budgets for their IAFs than other companies (cf., Carcello *et al.*, 2005b; Sarens and Abdolmohammadi, 2011). This literature suggests that the nature of the industry makes a difference on the role of IAF in corporate governance. Thus, we include a control variable to represent financial/non-financial industry for which we expect a positive sign.

The next control variable is listed vs. non-listed firms. Listed firms have a more dispersed ownership structure than private companies and are more attuned to the traditional principal-agent conflicts (La Porta *et al.*, 1998). Listed firms are also more influenced by corporate governance guidelines and laws. This implies that listed firms have better governance mechanisms for their monitoring role, including a more effective IAF than non-listed firms. Thus, we expect the chance for the IAF to play an active role in corporate governance to be higher within listed firms.

Firm size is our next control variable. Carcello *et al.* (2005b) and Goodwin-Stewart and Kent (2006) find firm size to be positively associated with the extent to which firms invest in their IAF which increases theoretically their chance to play and active role in corporate governance.

The literature also suggests that the scope of the firm (i.e., domestic vs. international) has implications for the role of the IAF in corporate governance. For example,

Khanna and Palepu (2004) argue that the more a firm is integrated into worldwide markets, the more it is subject to global competition and the more it will be motivated to adopt best practices (cf., Yoshikawa and Rasheed, 2009). Therefore, we expect a higher likelihood for IAFs to play a role in corporate governance in international firms than in domestic firms. Related to the firm scope is whether or not IAF is required by law. Sarens and Abdolmohammadi (2011) report that in countries where having an IAF is required by law, companies have more extensive budgets for their IAFs than in countries where having an IAF is not required by law which again increases the likelihood to play an active role in corporate governance.

Next, the literature suggests that internal auditing practice is influenced by the strength of the internal control system (Sarens, 2009; Sarens and De Beelde, 2006a). Furthermore, Sarens and Abdolmohammadi (2011) show that a supportive control environment has a significant positive effect on the relative size of the IAF, which the authors view as a proxy for the relative importance of the IAF in organizations. Therefore, we control for the existence of an internal control framework within the firm, and expect a positive sign.

Finally, the literature suggests that CAEs' professional experience and certification are positively associated with the IAF having a role in corporate governance. For example, discussing the ideal profile of a skilled and qualified CAE, Rittenberg and Anderson (2006) identify experience and certification as important factors. Thus, we control for these two CAE characteristics and expect positive signs for them.

2. Research Method

CBOK (2006) is a comprehensive database on the state of knowledge in internal auditing world-wide. It was developed and validated by the Institute of Internal Auditors Research Foundation (IIARF) through a survey of its membership in 2006. It has data from over 100 countries, thus it provides opportunities for comparative studies of various countries. However, for the purpose of our study where we needed CAE responses, only the U.S. had ample sample size (n=782) for statistical analysis. The samples of CAEs in other countries were too small for meaningful comparative analysis. Another reason for our choice of U.S. CAEs is that the internal auditing profession has the longest history in the U.S. Ramamoorti (2003) explains that major

milestones in the creation of the professional internal auditing community were originated in the U.S.

We make the assumption that an IAF has only one CAE, thus our dataset of CAEs represents 782 IAFs. Using a binary questioning mode in CBOK (2006) the CAEs indicated whether their IAFs had an active role in their firm's corporate governance. Thus the dependent variable in our study is binary (yes/no).

The independent variables related to the four hypotheses are measured by four binary variables as well. Specifically, the IAF has a risk-based audit planning method (yes/no); the IAF has currently a quality assurance and improvement program in place (yes/no); audit committee input is taken into account when making IA planning (yes/no); and management input is taken into account when making IA planning (yes/no).

CBOK (2006) uses the following scales to measure the control variables. Banking or insurance company (yes/no); listed firm (yes/no); firm size (logarithm of the total number of employees); international organization (yes/no); IAF is required by law (yes/no); existence of an internal control framework (yes/no); CAE tenure (in number of years); and the CAE has at least one IA certification (yes/no).

Model Specification. Due to the binary nature of the dependent variable, the following logistic regression model is specified for our investigation:

$$\begin{aligned} IAF_CG = {} & \alpha + \beta_1 Risk_Based_Plan + \beta_2 QAIP + \beta_3 Input_AC + \beta_4 Input_Mgt + \beta_5 \\ & Bank_Insurance + \beta_6 Listed + \beta_7 Firm_Size + \beta_8 International + \beta_9 \\ & IAF_Law + \beta_{10} IC_Framework + \beta_{11} CAE_Tenure + \beta_{12} \\ & CAE_IA_Certification + \varepsilon \end{aligned} \quad (1)$$

IAF_CG	The IAF currently plays an active role in corporate governance (yes/no)
Risk_Based_Plan	The IAF has a risk-based audit planning (yes/no)
QAIP	The IAF has currently a quality assurance and improvement program in place (yes/no)
Input_AC	Audit committee input is taken into account when making the planning (yes/no)

Input_Mgt	Management input is taken into account when making the planning (yes/no)
Bank_Insurance	Banking and insurance company (yes/no)
Listed	Listed (yes/no)
Firm_Size	Logarithm of the total number of employees
International	International organization (yes/no)
IAF_Law	The IAF is required by law (yes/no)
IC_Framework	The firm has implemented an internal control framework (yes/no)
CAE_Tenure	The number of years of experience as CAE
CAE_IA_Certification	The CAE has at least one IA certification (yes/no)

3. Results

3.1 Univariate Statistics

Table 1 provides descriptive statistics for the binary (Panel A) and continuous (Panel B) independent variables. With respect to the dependent variable, we note that according to CBOK (2006), 58.3 percent of the responding U.S. IAFs indicated that they played an active role in corporate governance. With respect to the IAF characteristics, Table 1, Panel A shows that 91.0 percent of the IAFs' have risk-based audit planning methods and 29.3 percent have a quality assurance and improvement program currently in place. About two thirds of the IAFs consider the input of the audit committee when making their audit planning (67.7 percent) while a larger group of IAFs take into account management's input (79.5 percent). One fourth of the responding firms operate in the banking and insurance industry (25.5 percent); 40.5 percent of the firms are listed; 27.9 percent operates on an international scale; 57.3 percent have established an IAF because it was mandatory; two thirds have an internal control framework in place (66.6 percent); and 56.0 percent of the CAEs in the study posses at least one professional certification in internal auditing (e.g., CIA).

Table 1: Univariate Statistics (Independent Variables)

Panel A: Binary Independent Variables	**Overall**	**Dependent Variable: The IAF currently plays a role in corporate governance**		**Chi-Square (p-value)**
		No	**Yes**	
Risk_Based_Plan	91.0	85.9	94.6	14.455 (.000)
QAIP	29.3	22.5	34.4	10.628 (.000)

Panel A: Binary Independent Variables	Overall	Dependent Variable: The IAF currently plays a role in corporate governance		Chi-Square (p-value)
Input_AC	67.7	58.4	74.3	17.721 (.000)
Input_Mgt	79.5	75.6	82.3	4.285 (.038)
Bank_Insurance	25.5	27.5	24.1	1.003 (.316)
Listed	40.5	27.9	49.5	31.114 (.000)
International	27.9	23.2	31.1	4.871 (.027)
IAF_Law	57.3	51.1	61.7	7.348 (.007)
IC_Framework	66.6	57.6	73.1	17.270 (.000)
CAE_IA_Certification	56.0	51.8	59.1	3.439 (.064)

Panel B: Continuous Independent Variables		No	Yes	t-value (p-value)
Firm_Size (FTE)	14,648	40,856	9.411	1.103 (.271)
CAE_Tenure (number of years)	6.90	6.66	6.95	-.564 (.573)

Variables Definitions:

Risk_Based_Plan	The IAF has a risk-based audit planning (yes/no)
QAIP	The IAF has currently a quality assurance and improvement program in place (yes/no)
Input_AC	Audit committee input is taken into account when making the planning (yes/no)
Input_Mgt	Management input is taken into account when making the planning (yes/no)
Bank_Insurance	Banking and insurance company (yes/no)
Listed	Listed (yes/no)
Firm_Size	Logarithm of the total number of employees
International	International organization (yes/no)
IAF_Law	The IAF is required by law (yes/no)
IC_Framework	The firm has implemented an internal control framework (yes/no)
CAE_Tenure	The number of years of experience as CAE
CAE_IA_Certification	The CAE has at least one IA certification (yes/no)

Table 1, Panel B provides summary statistics about firm size and CAE tenure. On average, the firm size is 14,648 full time equivalents. Regarding tenure, the CAEs in our sample have on average been in the CAE position for 6.90 years.

Table 1 also provides univariate significance tests for the binary (Panel A) and continuous (Panel B) independent variables. All binary independent variables, except for Bank_Insurance and CAE_IA_Certification are significantly different ($p < .05$) between IAFs that currently play an active role in corporate governance and those that do not. However, none of the continuous independent variables (Panel B) is

significantly different between the two groups.

3.2 Multivariate Statistics

Table 2 provides a correlation matrix for all dependent and independent variables in Model (1). As expected, the dependent variable is significantly correlated ($p < .05$) with four of the eight control variables, and all test variables. Another observation from Table 2 is that none of the correlation coefficients reaches the critical level of .50 to cause concern for the possibility of multicollinearity. Consistent with this conclusion variance inflation factors are lower than 1.04.

Table 2: Correlation Matrix

	IAF_CG	Bank_Insurance	Listed	Firm_Size	International	IAF_Law	IC_Framework	CAE_Tenure	CAE_IA_Certification	Risk_Based_Plan	QAIP	Input_AC	Input-Mgt
IAF_CG	1.000												
Bank_Insurance	-.039	1.000											
Listed	.217**	-.045	1.000										
Firm_Size	.027	-.337**	.269**	1.000									
International	.086*	-.208**	.327**	.329**	1.000								
IAF_Law	.105**	.115**	.288**	.092*	.047	1.000							
IC_Framework	.162**	.057	.303**	.097**	.097**	.437**	1.000						
CAE_Tenure	.022	-.003	-.105**	.031	-.037	-.041	-.059	1.000					
CAE_IA_Certification	.072	-.089*	-.077*	.036	-.068	-.046	-.030	.107**	1.000				
Risk_Based_Plan	.151**	.122**	.118**	.011	.078*	.122**	.128**	.003	.046	1.000			
QAIP	.130**	-.050	-.069	.223**	-.004	.092*	.046	.068	.147**	.153**	1.000		
Input_AC	.167**	.106**	.149**	.017	.078*	.057	.108**	.060	.021	.230**	.023	1.000	
Input_Mgt	.082*	-.084*	-.021	.045	-.006	.004	-.055	.026	.054	.151**	.076	.274**	1.000

* : $p < .05$ **: $p < .01$

See Table 1 for definitions of variables

Table 3 provides the results from a binary logistic regression analysis of Model (1). The model has significant explanatory power (63.3 percent classification accuracy and a *pseudo* R^2 of 15.8 percent). Regarding the control variables, Table 3 indicates that the chance for IAFs to have an active role in corporate governance is significantly higher for listed firms than for non-listed firms ($p < .001$). Furthermore, the chance for IAFs to have an active role in corporate governance is significantly but negatively associated with firm size ($p = .006$). This result is inconsistent with our expectations. Also, we find that the existence of an internal control framework is significantly and positively associated with the chance for IAFs to play an active role in corporate governance ($p = .020$). Finally, CAE certification is significantly and positively associated with IAFs having an active role in corporate governance ($p = .011$).

Table 3: Binary Logistic Regression Analysis

$IAF_CG = \alpha + \beta_1 Risk_Based_Plan + \beta_2 QAIP + \beta_3 Input_AC + \beta_4 Input_Mgt + \beta_5 Bank_Insurance + \beta_6 Listed + \beta_7 Firm_Size + \beta_8 International + \beta_9 IAF_Law + \beta_{10} IC_Framework + \beta_{11} CAE_Tenure + \beta_{12} CAE_IA_Certification + \varepsilon$

Variable	Exp. Sign	Beta	Wald	Sign.
Bank_Insurance	+	-.292	1.671	.098
Listed	+	.921	17.465	**.000****
Firm_Size	+	-.131	6.273	**.006****
International	+	.139	.376	.270
IAF_Law	+	.024	.015	.452
IC_Framework	+	.420	4.271	**.020***
CAE_Tenure	+	.009	.440	.254
CAE_IA_Certification	+	.420	5.214	**.011***
Risk_Based_Plan	+	.639	3.976	**.023***
QAIP	+	.547	6.767	**.005****
Input_AC	+	.489	6.082	**.007****
Input_Mgt	+	.280	1.481	.112
Error		-.922	3.020	**.041***
N		586		
Chi square		73.155 (p = .000)**		
Classification accuracy		63.3%		
Nagelkerke (pseude) R^2		.158		

* : $p < .05$ **: $p < .01$

See Table 1 for definitions of variables

Overall, we find statistical support for Hypotheses 1-3, but not Hypothesis 4. Specifically,

IAF having an active role in corporate governance is significantly more likely when the IAF has a risk-based audit planning ($p = .023$), and when the IAF has a quality assurance and improvement program in place ($p = .005$). With respect to the input from other stakeholders, we find that the chance for the IAF to have an active role in corporate governance increases significantly ($p = .007$) when input from the audit committee is taken into account for audit plans which is consistent with Hypothesis 3. However, we find no significant relationship between IAFs having an active role in corporate governance and management input for the audit planning (Hypothesis 4).

4. Summary, Limitations, and Conclusions

4.1 Summary

We find significant positive associations between the IAF having an active role in corporate governance and the use of risk-based auditing; having a quality assurance and improvement program in place; and input from the audit committee for audit planning. We also find that control variables such as listed firms, firms that have implemented an internal control framework; and firms where the CAE has at least one IA qualification are also positively and significantly associated with an IAF having an active role in corporate governance. The results also show a significant, but negative association between firm size and IAFs having an active role in corporate governance.

4.2 Limitations

The CAEs whose responses are used in this study were highly experienced and competent with the subject matter of internal audit practice, thus their educated responses provide valuable data for analysis. Nevertheless, CAE perceptions may potentially deviate from actual practice. Future research in which limitations of perceptual data can be mitigated may be needed for further investigation. For example, a small sample of CAEs may take part in an experimental setting where test variables are manipulated and their effects measured. Another possibility is to investigate the relationship between IAFs playing an active role in corporate governance and various explanatory and control variables using a small number of companies through field work.

The data used in this study is limited to responses from CAEs of U.S. organizations. It was desirable to conduct a comparative study by including CBOK (2006) data from CAEs

of non-U.S. organizations. However, while CBOK (2006) has data from over 100 countries, the samples of CAEs from each of these countries are too small for a meaningful comparative study. In contrast the ample sample of U.S. organizations (n=782) makes statistical analysis valid and reliable. However, caution must be exercised in generalizing our results from U.S. CAEs to other countries.

Another limitation of our study is that CBOK (2006) database is limited to the IIA membership, thus it may not reflect the views of practicing internal auditors who are not members of the IIA. Future studies may benefit from including these professionals in their investigation.

4.3 Conclusions

Corporate governance gained much attention in recent years due to the scandalous frauds of the early 2000s (McCollum, 2006; Arnold, 2010; Wittenberg, 2010). Given this background, it is curious as to why CBOK (2006) indicates that some 41.7 percent of the IAFs do *not* play an active role in corporate governance. CBOK (2006) also indicates that only 6.5 percent of the IAFs' working time is allocated to governance issues. To the extent that it is desirable to have a stronger role in corporate governance, IAFs may benefit from our research because we provide evidence on variables that are significantly associated with the IAF having an active role in corporate governance. Note that these variables were suggested in both the academic and professional literature but had never been tested before.

Our results also have implications for CAEs who wish to increase their IAF's role in corporate governance by providing services that are better aligned with the needs of their clients, such as the audit committee. For example, CAEs may seek input from the audit committee when making their audit plans, and apply a risk-based audit approach to ensure that their work is focused on areas of concern to their organizations (cf. IIA, 2009; IIA UK and Ireland, 2005a; 2005b). This finding supports the argument that an IAF that has a risk-based audit focus will place its mission on stronger support for corporate governance stakeholders (cf. Allegrini and D'Onza, 2003; Burnaby and Hass, 2009; PwC, 2009). This result is also consistent with arguments in prior research that the relationship between the IAF and the audit committee is important not only for both parties but also to strengthen corporate governance (cf. Gendron *et al.*, 2004; Gendron and Bédard, 2006; Raghunandan

et al., 2001; Scarbrough *et al.*, 1998).

Our results also suggest that the effectiveness of an IAF (whether or not playing an active role in corporate governance can be considered as an important proxy) depends on its interactions with other corporate governance mechanisms as suggested by Goodwin (2003) and Ratcliffe (2009). We find that the relationship with the audit committee is associated with an IAF role in corporate governance. This is consistent with Sarens et al.'s (2009) results indicating that the IAF and the audit committee have complementary roles within corporate governance. The finding that input from management has no significant impact on the chance for the IAF to play a role in corporate governance was unexpected and deserves further investigation, especially in light of Cohen and Sayag's (2010) finding that support of top management as the prime determinant of IAF effectiveness, which turns out not to be the case in our U.S. setting. We acknowledge that there can be big differences between countries. In order to play an active role in corporate governance, should the IAF be seen as an agent working for the audit committee, management, or both? Future research may be needed to find evidence on who is the 'boss' of the IAF (cf. Chambers, 2008; Lenz and Sarens, 2011b)?

Our results also suggest that IAFs should be encouraged to put in place quality assurance and improvement programs as recommended by Standard 1300 because this program is positively associated with the IAF having an active role in corporate governance. This finding supports the argument that investing in the active monitoring and improvement of the IAF quality helps IAF to play a more active role in the corporate governance debate (cf. Elliot et al., 2007). The IIA has an important role to play by promoting this practice and encouraging its members to participate in this activity.

The results related to control variables are generally consistent with expectations. However, unexpectedly we find that firm size is inversely associated with the chance for the IAF to play an active role in corporate governance. Further research is needed to investigate why IAFs in larger firms that are supposed to have more budgets for their IAFs (cf. Carcello *et al.*, 2005b; Goodwin-Stewart and Kent, 2006) have lower association with an active role in corporate governance than those in smaller firms.

This study also shows that the existence of an internal control framework, without measuring internal control quality, increases the chances for the IAF to play an active role

in corporate governance. This finding supports Sarens (2009) and Sarens and Abdolmohammadi's (2011) results that the internal control system in general, and the control environment more specifically, has a positive impact on the IAF. Complementary to studies that investigate how an IAF can increase internal control quality, future research is needed to investigate a potential opposite relationship; namely the extent that internal control quality is associated with an IAF's role in corporate governance.

Finally, prior research (e.g., Pforsich *et al.*, 2006, 2008; Rittenberg and Anderson, 2006) suggests that the CAE plays a crucial role ensuring that the IAF has an active role in corporate governance. We find that CAEs' certification (e.g., CIA or equivalent) is positively associated with the IAF having an active role in corporate governance. Future research may benefit from investigating the relationship between additional CAE professional/personal characteristics and the IAF's role in corporate governance.

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PAPER 3

REFLECTIONS ON THE INTERNAL AUDITING PROFESSION: WHAT MIGHT HAVE GONE WRONG?

Abstract

Purpose - To investigate and discuss potential reasons why the internal auditing (IA) profession has been marginalized in the governance debate on solutions after the financial crisis that started in 2007, also noting recent studies questioning the value of IA's work. The key purpose of this paper is to make readers aware of ambiguities concerning the ultimate customer of IA and its core business, and to stimulate critical reflection thereon.

Design/methodology/approach - The conceptual discussion of this paper is based on an objective review of relevant literature, both practitioner and academic.

Findings - Positioning IA as agent to the board/audit committee and, at the same time, as partner to management is challenging in practice. The IA function should clarify the customer dimension in its organizational context. Furthermore, this paper argues for a consolidation of internal audit around its core function of providing assurance when seeking to establish IA as a profession.

Practical implications – Practitioners will benefit as this paper demands fundamental questions to be addressed in the organizational context, about the ultimate customer and the core business of the IA service rendered. The Institute of Internal Auditors will benefit from this paper and subsequent discussions in academia and practice, supporting its pursuit to gain universal recognition for IA as a profession.

Originality/value - This paper may open a new research area in IA that addresses a more critical way of evaluating IA practices.

Keywords Internal auditing, corporate governance, profession

Paper type Conceptual paper

Introduction and background

IA has not been generally seen to have a significant role in the financial crisis, neither as part of the problem nor as part of the solution. An acknowledgement that the internal auditing profession has been marginalized in the corporate governance debate since the financial crisis that started in 2007 serves as a starting point for this paper, which reviews the profession's situation between that time and 2010. Parallel to IA's becoming further marginalized in the governance debate on solutions, recent studies have been questioning the value of IA's work, too. The conceptual discussion of this paper is based on an objective review of this relevant literature (both practitioner and academic). The revisions of the International Standards effective 1 January 2011 (IIARF 2011a) are considered a consequence of the crisis and are referenced in the conclusions.

The professional status of IA is an important issue since IA is still searching for an identity and a Unique Selling Proposition (USP) in order to play a more important role in the governance debate. At present, there are limitations, some self-inflicted, regarding the role of IA as a core principle of good corporate governance: IA has multiple customers to serve, and IA aspires to render both assurance and consulting services. Positioning IA as agent to the board and, at the same time, as partner to management is challenging in practice, as there are potential tensions between the board and management. Whilst the board's/audit committee's priority is focused on risk oversight and reducing the downside of risk (Ernst & Young 2006a, 11), the growth and performance objectives of management require active risk-taking, seen as an inseparable element of strategy and a crucial driver in achieving objectives, including optimizing value over time (ICGN 2010, 4). These different perspectives, different incentives and risk tolerances may mean that, if everyone expects something different from IA, no one is likely to be satisfied in full. This potential for dissatisfaction increases since IA aims at rendering assurance and consulting services on governance, risk management and control processes, a goal that may demand more than IA is able to deliver. The more IA lacks a distinct chief stakeholder/"boss" and a clear and realistic role, the more it is principally exposed to over-promising and under-delivering.

The paper suggests that, in order to become a more relevant stakeholder in the corporate governance debate, the IA profession should clarify both the perspective and the purpose of IA. Consequently, determining to whom IA should be accountable (the perspective

from which its added value is judged) and concentrating the IA's service offering (the purpose) is expected to help the profession acquire a higher profile on boards and audit committees.

This paper contributes to and invigorates the academic discussion of the role and added value of IA in the governance arena. Academic researchers should be interested in this paper because it can open a new research area in IA that addresses a more critical way of evaluating IA practices, rather than descriptive studies that aim at helping the profession gain recognition and professional status. Practitioners are expected to benefit from this paper, as it addresses fundamental questions about the ultimate customer and the core business of the IA service rendered, acknowledging the variety of services required in reality. Eventually, the Institute of Internal Auditors (IIA) is expected to benefit from this paper and subsequent discussions in academia and practice, as it aspires to gain universal recognition for IA as a profession by the year 2014 (IIA 2010a and Meggeneder 2010).

Section 1 provides evidence that post-financial-crisis activities have remained almost completely silent about IA's role (Baker 2010). The profession has been marginalized, receiving no additional attention from policy makers in the aftermath of the recent crisis. This fact forms the starting point of this paper. Section 2 reviews the value perception of key users of IA, namely, board, audit committee, and senior management members. IA seems to be often over-promising and under-delivering.

Sections 3 and 4 then explore where IA could have gone wrong. At present, IA is viewed as lacking both a clear chief stakeholder/"boss" and a clear role. The paper suggests two solutions as contributions to the conceptual discussions: more clearly determining the perspective from which the added value of IA should be judged and concentrating the purpose of IA on its core business. These solutions are presented as avenues that can help to establish the identity of IA as a profession and enhance its relevance in the governance discussion.

Finally, section 5 presents conclusions, refers to the latest changes in the IIA Standards (IIARF 2011a) as a consequence of the recent financial crisis, and suggests further areas for research.

1. Silence on internal auditing in the governance debate

Corporate governance and risk management failures not only did not prevent, but actually facilitated corporate collapses like those Enron/WorldCom, the Parmalat and Ahold cases in Europe and, more recently, Lehman Brothers (OECD 2009). Evaluating and improving the effectiveness of risk management, control, and governance processes of an organization are the core claim of internal auditing (IIARF 2011a). Consequently, during the 2010 International Conference of The Institute of Internal Auditing (IIA), R. Anderson asked where internal auditors were when such events occurred, challenging the relevance of the IA profession (Swanson 2010, 1). The role of IA in the crisis itself is not the main subject of this paper, however it is worth noting that the financial crisis inquiry report in the US mentions IA three times stating that IA had identified numerous deficiencies, but warnings were ignored, and the supervisory program lacked the appropriate level of focus on risk oversight and the IA function (Financial Crisis Inquiry Commission 2011, 157, 160 and 303). This criticism acknowledges potential of IA possibly preventing or mitigating the damage. As IA's voice was unheeded, that potential power of IA was largely untapped in the crisis, and thereafter, too. It is striking that the IA profession has hardly been considered by other governance stakeholders as a source of solutions to the problems that led to the financial crisis; post-financial-crisis activities have remained almost completely silent about IA's role (Baker 2010).

For example, on 16 December 2009, the Securities and Exchange Commission in the US announced its "Enhanced Disclosures about Risk, Compensation and Corporate Governance," which became effective 28 February 2010, without mentioning IA at all (SEC 2009). During the time that draft versions were under review, Richard Chambers, President and CEO of IIA, wrote a response letter to the SEC (Chambers R. 2009), outlining the potential contributions that IA could make, an effort performed in vain, as the final version of the SEC release indicates.

Another example is the Walker Report (2009) in the UK, which references IA six times in its text, but not in any of the five themes or 39 recommendations made to address the question of how to improve corporate governance in UK banks. Consequently, in a review of the Walker Report, Leblanc (2010) references IA once as example of an internal assurance provider but never as an authority on the subject matter that should be included in discussions. The IA community regards the Walker Report as unfortunate and as a

missed opportunity for IA as it says nothing about the key role that IA should have in the context of corporate governance (Baker 2010).

Furthermore, the revised UK corporate governance code, published in May 2010, fails to increase the importance of IA (FRC 2010). The audit committee is still requested to monitor and review the effectiveness of a company's internal audit function (FRC 2010) and to include in the annual report the reasons for the absence of the IA function where it is absent (FRC 2010). Therefore, it is little surprise that the Institute of Internal Auditors UK and Ireland only cautiously welcomed the new corporate governance code (IIA UK and Ireland 2010a).

Thus, the recent financial crisis that commenced in 2007 seems to have further marginalized the role of IA; the IA profession is largely ignored when other governance stakeholders seek solutions to problems. However, some capital market environments recognize the importance of IA. For example, the New York Stock Exchange requires that all listed companies have an internal audit function (NYSE section 303A.07). However, the NYSE-sponsored commission on Corporate Governance, in outlining ten core governance principles, does not mention IA at all (NYSE 2010). While the NYSE rules mandate the presence of an internal audit function, the size and nature of that function are not specified, and the NYSE does not address the effectiveness of the internal audit function (Carcello *et al.* 2005). Consequently, having an internal audit function (IAF) is not the same as having a value-adding and effective IAF, as several stakeholder surveys have indicated.

2. Value of IA questioned

The IA definition from 1999 (unchanged since then) demands that IA provides assurance and consulting activity to evaluate and improve the effectiveness of risk management, control and governance processes (IIARF 2011a, 2):

"*Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes*."

When regarding this as the benchmark, there are some common themes in a number of studies pointing to significant shortcoming in reality, predominantly big holes in practice when comparing factual and targeted scope of IA services, the absence of clearly conveying value added to major stakeholders, and overly optimistic self-assessments by internal auditors.

2.1 Big holes in practice when comparing factual and targeted scope of IA services

The Common Body of Knowledge (CBOK 2006) study indicates that about one-third of internal auditors currently have no role in risk management, and half have no role in corporate governance (IIARF 2007, 55). The CBOK 2010 study shows that about 57 and 45 percent of internal audit activities include audits of enterprise risk management processes and corporate governance reviews, respectively (IIARF 2010a, 24). This finding signals a gap between what the IA definition claims IA provides and what is actually delivered in practice, despite the wide availability of guidance on risk management (see IIA UK and Ireland 2005 and IIA 2009) and organizational governance (IIA 2006) for the profession.

Some may find that this line of argumentation is too harsh; considering that risk management itself may be regarded as an emerging function, IA's limited role may be expected. However, it cannot be disputed that IA does not always deliver on its own commitment more than ten years after devising its own definition. IA often over-promises and under-delivers, a view supported by practice-orientated literature that is pointing towards the significant shortcomings of IA in meeting the expectations of its stakeholders.

2.2 Absence of clearly conveying value added to major stakeholders

The stakeholder survey conducted by Deloitte and the IIA UK and Ireland (2008) reveals that about two-thirds of internal audit functions surveyed do not have to demonstrate their value, suggesting that IA may not know whether it is doing the "right things" and, thereby, delivering value to boards, audit committees and senior management. A comparison of the present study with Baker (2003) reveals that the core value-generating activities of IA work have remained unchanged over the years: customers of IA services in 2008 ranked assurance at the top of its agenda, as they did in 2003, when the vast majority of stakeholders ranked assurance that major business risks are being managed appropriately and that the internal control framework is operating effectively as IA's most

important value-generators (Baker 2003, 12). Those areas to which stakeholders believe IA contributes the most value were the same in the 2008 study, although assurance concerning governance processes was also expected to gain significant importance (Deloitte and the IIA UK and Ireland 2008, 8). This comparison suggests that IA does not forget the basics when assuming more business-like or more consultant-like roles.

In the 2009 Public Company Audit Committee Survey (KPMG 2009), many survey respondents stated that IA could be delivering greater value to its organization. Only 26 percent of respondents were very satisfied with the IA services rendered, while only 29 percent of respondents (board and audit committee members) were very satisfied that the audit committee, the internal auditor, the CEO, the CFO, and other senior management had a clear, shared vision of the role of IA at the company. Consequently, in less than a third of cases did board and audit committee members have full knowledge of IA activities and their value to the organization; in the large majority of cases, IA activities and the value they provide remained somewhat obscure.

These studies predominantly from consulting and financial accounting companies document some degree of disappointment of key users in IA's performance. It is acknowledged that there may be questions about the rigor of such surveys conducted by professional firms especially as their view may be biased, as after all, they are in the business of selling IA services. Therefore, further sources are referenced to support the argument.

Beasley et al. (2009, 114) "*highlight the often nebulous, informal nature of internal audit oversight by audit committee and management*". R. Anderson (2009, 26) concurs in his report commissioned by the OECD: "*Non executive directors and Audit Committee chairmen are often surveyed and respond that: Heads of internal audit are not up to the job, internal audit lacks adequate independence… They have not properly defined the role that they wish internal audit to fulfill*". Similarly, e.g. Elliot et al. (2007) conclude that internal audit reports are not always well received; they are sometimes not performed well; and the findings are not always particularly significant, at times being trivial. This opinion concurs with that of Spira and Page (2003) who refer to a rhetoric gap between IAs' intended role and their clients' perception of its role. Van Peursem (2007) sees the role of internal auditors as enigmatic.

Sarens and De Beelde (2006a) point out that a higher level of risk-based internal auditing is needed, affording the IA function a more important role in risk management. Sarens and De Beelde (2006b) investigate the relationship between internal audit and senior Management (CEOs and CFOs), and conclude that the acceptance and appreciation of internal audit within a given company are strongly dependent upon the support they receive from Senior management; a view that is concurred by Cohen and Sayag (2010) when studying determinants of IA effectiveness in Israeli organizations. Similarly, Mihret and Yismaw (2007) rank inadequate management support as the prime reason for the ineffectiveness of the IA function when performing a case study on internal audit effectiveness within an Ethiopian public sector organization. This is in line with Halimah *et al.* (2009), too, viewing the limited effectiveness of IA functions in the Malaysian public sector largely caused by a lack of support from top management.

Whilst the latest CBOK 2010 study testifies that most respondents believe (according to their self-assessment) that their IA activities add value to the organization especially when contributing to controls, to a lesser degree when contributing to risk management and governance (IIARF 2011c, 10), the stakeholder perspective clearly signals the challenge for IA to become more relevant and valuable to the organization and gain trust and confidence of the executive suite, including Directors, Audit committee chairs and members, Chief executive officers and Chief financial officers (IIARF 2011b, 17).

2.3 Overly optimistic self-assessments by internal auditors

What is striking is the significant disconnect between the "supply-side perspective" of the profession, i.e., typically self-assessments by internal auditors, and the "demand-side perspective" of the IA profession, the stakeholder's expectations and perceptions (IIARF 2011b). The stakeholder survey conducted by Ernst & Young (2006b, 29) evidences grave differences between the self-assessment of internal auditors and the perspective of other key stakeholders, e.g., whereas 81 percent (100 percent in banks) of Heads of Internal Audit (CAE) self-assess their acceptance in the organization and professionalism as outstanding that is seen much muted in the eyes of Senior management scoring 55 percent only. The self-perception and external perception differ greatly, which is regarded to partly stem from hubris on behalf of internal auditors and partly be attributable to lack of understanding on behalf of management what services IA is actually providing.

Interestingly, this E&Y- study of 175 companies concludes that internal auditors consider themselves as internal consultant whereas management would like them to assess and improve risk management processes and secure adequate corporate governance processes. Equally, Hölscher and Rosenthal (2009) point to big gaps between the self-assessment of internal auditors (which tends to be more favourable) and the perception of performance by senior management.

Consequently, the IIA may be misled in its belief that IA is a valuable resource to an organization's executive management and governing body (IIA 2010b) *per se*, as it seems that some IA functions have lost sight of their customers. The following discussion explores whether the silence in the governance debate (section 1) and some degree of disappointment of key users with the perceived value that IA is providing (section 2) are attributable to confusion about (1) who is the chief stakeholder/"boss" of IA and (2) what is the fundamental role of IA.

3. Internal auditing has no clear chief stakeholder/"boss"

The IIA recommends a dual reporting relationship in which the CAE reports functionally to the board (or the audit committee of the board) and administratively to a senior management executive. According to the interpretation of Standard 1100 (Independence and Objectivity), such dual-reporting relationship is regarded as a best practice in order to achieve the degree of independence necessary to carry out the responsibilities of the internal audit activity effectively (IIARF 2011a, 16). In practice, about two-thirds of CAEs report administratively to senior management, in most cases to the Chief Executive Officer (IIARF 2010a, 34).

The IIA acknowledges that there may be conflicts when IA tries to "serve two masters" (IIARF 2003, 3). Academics (e.g., Chambers 2008, U. Anderson 2003, Hermanson and Rittenberg 2003) and practitioners (e.g., Deloitte 2010 and Marks 2010) challenge whether this dual reporting relationship is optimal. The "who's your boss?" issue can present problems in terms of allegiances, independence, and effectiveness (Deloitte 2010, 5). The current paper suggests exploring the customer dimension of IA further and considering the oversight authority more clearly as a prime customer group. In this way, the traditional concept of the IIA is abandoned that views IA as an 'agent of the board' and as a 'partner to management' (IIA 2006).

IA currently has multiple customers to serve. Ratcliffe (2009) pictures the complexity of the role of internal auditors, suggesting that IA professionals should be sensitive to the differing needs of the board, the audit committee, and senior management and that forming the right relationships is instrumental to understanding those needs. Ratcliffe points to potential and possibly substantial differences in what the audit committee wants, what the board wants, and what senior management wants. The audit committee, as a sub-committee of the board, is typically largely concerned with the quality of financial statements (Ratcliffe 2009, 1), and audit committee members also identify rising levels of regulatory and compliance risks (Ernst & Young 2006a, 3). The audit committee is a frequent addressee of IA services, as defined by prominent regulatory requirements, such as governance codes (e.g., NYSE Listed Company Manual's section 303A.07; the UK Corporate Governance Code 2010's FRC 2010; and the 8th Directive of the European Union's Directive 2006/43/EC, Article 41). The reporting line into the audit committee as a sub-committee of the board is broadly supported by academia, as well. Scarbrough *et al.* (1998), for example, regard the relationship between the audit committee and the IAF as symbiotic, and Goodwin (2003) views the independence of the audit committee and the level of accounting experience as enablers of the IA function's ability to contribute and strengthen corporate governance. However, this view is not entirely undisputed in academia. For example, the study by Rose and Norman (2008) suggests that requiring the IA function to report directly to the audit committee may create threats to IA's independence and objectivity because of concerns about career and reputation, overreaction of audit committee members, retaliation by management, and the requirement that solutions be offered when fraud risks are reported. Rose and Norman's study suggests that unexpected and adverse implications must be considered when implementing new legal requirements, such as the requirement that IA report directly to the audit committee.

The board typically has a bigger perspective than the audit committee, is constantly seeking a better business and concerned with long-term company survival (Ratcliffe 2009, 2). Huse (2007, 15 and 35) regards value creation as main task of the board viewing board accountability as core concept acknowledging interests of shareholders (providers of capital) and other relevant stakeholders, e.g., providers of labor and management. The board has an overarching responsibility for deciding the company's strategy and business

model and understanding and agreeing on the level of risk that goes with it, which is viewed as applicable to single-tier and two-tier board structure (ICGN 2010, 5). Non-audit-committee members of the board place significant emphasis on business and performance risks, whilst audit-committee members tend to focus primarily on compliance and financial reporting risks (Ernst & Young 2006a, 5-6).

The board is responsible to assure effective oversight of risk management, and the board should hold management accountable for designing and implementing a risk management system (ICGN 2010, 8). Whilst the board's priority is more focused on reducing the downside of risk and emphasizing risk mitigation, the growth and performance objectives of senior management mandate active risk-taking (Ernst & Young 2006a, 3). Thus, there are potential tensions between the board and senior management. Lehman may serve as one example in practice, where management did not inform the board timely that Lehman had exceeded the firm-wide risk appetite limit (Valukas 2010, 117). It is worth noting, whilst the IIA-Performance Standard (PS) 2600 (Resolution of Senior Management's Acceptance of Risks) requests the CAE to discuss matters with senior management that may be unacceptable to the organization (IIARF 2011a, 41), there are low compliance percentages with PS 2600 (52.8 percent on average; IIARF 2010a, 65) which may indicate reluctance among some CAEs to go to the board with issues where the CAE and management disagree (IIARF 2010a, 33). Open and candid dialogue that may be required is not happening in practice in every other IA function, the compliance with PS 2600 is seen as a barometer of how well internal auditor independence is actually working within organizations (IIARF 2010a, 34).

Moreover, when IA serves two masters, senior management and the board, what IA reports to the board may be filtered by management, such that only what is palatable to management is communicated (Chambers 2008). Ratcliffe (2009, 5) summarizes this issue bluntly: *"If [the Chief Audit Executive says] anything serious to the Chairman which [he or she hasn't] already said to the CEO, [the Chief Audit Executive should not] expect to be around for long."* The consistently low compliance percentage with PS 2600 indicates the reluctance of some CAEs to go to the board with issues about which the CAE and management disagree (IIARF 2010b, 33).

Consequently, U. Anderson (2003) sees IA as facing tension from its attempt to serve its two customers - managers and the audit committee - and questions whether the IAF is the

eyes and ears of management or the eyes and ears of the audit committee. Similarly, Hermanson and Rittenberg (2003) regard IA as facing potential structural conflicts when called upon to serve two masters: those primarily responsible for governance and those being governed - the board and management. Further, Prawitt (2003) questions who should evaluate the performance of the IAF. Beasley *et al.* (2009, 102-103) conclude that there is *"a substantial lack of clarity in internal audit's reporting channels … [and] there is significant potential for internal audit's loyalties to be divided as a result of multiple reporting channels (i.e., to the audit committee and management)"*.

Therefore, the audit committee and managers are two oversight participants that may bias the focus of the IA away from optimally addressing the business risks of the company (Abbott *et al.* 2010, 23). Whether the IAF allocates time and resources adequately or addresses what truly matters is contextual and is negotiated in the field among the relevant stakeholders. The experimental study by Hoos (2010) shows that internal auditors do follow the priorities of either the audit committee or management depending on the instructions of the CAE either stressing the priority of the audit committee (i.e., effectiveness) or the priority of management (i.e., cost reduction). That there is no congruence between what the board wants, what the audit committee wants, and what senior management wants deserves particular attention in considering how IA services should be rendered. Aiming at satisfying all customer groups is likely to disappoint one or the other customer in some dimension, as all may expect something different from IA, such that no one is fully satisfied (Deloitte 2010). Flesher and Zanzig (2000) concur, pointing to the lack of congruence in understanding among stakeholders concerning what makes IA a value-added activity. The result is underutilized audit services, ignored audit recommendations, and continued marginalization of IA in the corporate governance debate. Not delivering what is promised damages IA's credibility and jeopardizes its relevance.

Burns (1994, 92) sees the risk that internal auditors are intimidated by top management. Obviously, it makes a fundamental difference whether there is management that wants the IA to look at the right things and supports it doing so, or management that is silent or actually impedes IA from becoming effective and potentially unearthing things that management do not want to be found. With weak support of the IA function by the board/audit committee, in that case the CAE would face a problem. With strong support

of the IA function by the board/audit committee the CAE could report delicate findings or air concerns in full. Consequently, it is important that the CAE can confidently and reliably report, e.g., without fear of losing his or her job. It shall only be mentioned that the CAE might even face a bigger problem in case the board/audit committee is not acting competently and ethically, or has even fraudulent intentions. Then, this becomes rather the shareholders' problem. Further studying the role of IA in major corporate governance failures is suggested.

Focusing on one prime customer group foremost and aiming at satisfying the chief stakeholder first and in full is an alternative approach to targeting multiple customers at the same time and not satisfying anyone. Chambers (2008) suggests strengthening the link between IA and the board, particularly its non-executive directors. Chambers (2008) stresses that it is important that IA "get your boss right", viewing the full board as the prime customer to whom IA should report functionally and administratively. Deloitte (2010, 5) recommends removing any ambiguity about to whom the CAE reports and ensuring that IA's chief stakeholder/"boss" sits high in the organizational chart. Chambers (2009, 29) further suggests that, for IA to provide dependable board-level assurance, the audit function's budget must be viewed as a cost of running the board. However, that suggestion implies that there is an oversight body, which is not always the case. According to Chambers (2009), in the absence of such an oversight body, IA should report to the highest authority in the organization tasked with risk oversight, in this way securing independence the best opportunity to unlock the full potential of IA to protect the organization from value destruction.

This paper suggests viewing the oversight authority (board/audit committee) more clearly as the prime customer group, which abandons the IIA's traditional view of IA as an 'agent of the board', and at the same time positions IA as a 'partner to management' (IIA 2006). Following that path may be the way IA can leverage the governance opportunity that PWC (2010) suggests. However, on that journey, IA cannot be successful in unlocking its full potential if it attempts to do so in isolation. Its prime customers need to acknowledge the "added value" of IA. Interestingly, when suggesting imperatives for change for the IA profession the CBOK 2010 study concludes that the audit committee relationship will always remain primary for the CAE (IIARF 2011d, 46). This suggested clarity concurs with key arguments presented, i.e., the relevancy of IA can be helped when better

responding and focusing on the chief stakeholder first. Unfortunately, if we look at other documentations of the IIA (e.g. IIA 2006, 6), we must state that the customer dimension is not so obvious; the messages are not consistent.

4. Internal auditing has no clear role

Ramamoorti (2003) acknowledges that the challenge remains for internal audit professionals to develop a clear understanding of the value proposition they offer and to manage their perception and image both inside and outside of organizations. IA must be linked to business objectives or to the objectives of the organization it supports, as there is no IA without a business. Since IA is a service to a business, it is essential that the business as a whole determines the sort of IA it should have (Chambers 1992).

Defining added value and the fundamental role of employees who are not connected directly to profit and loss is not an easy task (Nobel 2010). The IIA definition (IIARF 2011a, 2) of the role of IA refers to an *"assurance and consulting activity evaluating and improving the effectiveness of risk management, control, and governance processes."* Supposedly, the audit committee or equivalent determines an explicit strategy that guides the IA function to find the right balance between assurance services and consulting (IIARF 2010a, 27). This process deserves further study in order to clarify what "balance" precisely means and how it operates in practice. Jensen (2001, 314) regards balance as a "hurrah word", as nobody can argue in favour of being unbalanced, and points to the danger that searching for balance may actually hinder careful analysis and thought on the issues. It can be questioned and must be further studied, how an auditor in practice manages both, at the same time in one engagement, or sequentially, one after the other; the auditee, too, should understand which process is underway.

U. Anderson (2003) regards the current positioning of the IA profession as a provider of assurance and consulting services as one of its major challenges and asks whether there could be an IA function that provided 'no assurance'. Chambers (2008) concurs, viewing the ambition of the IA profession to perform assurance and consulting activities more than it can deliver and, at the same time, as a hindrance to what IA has the potential to deliver: filling the board's assurance vacuum, thereby providing (particularly non-executive) directors an adequate, ongoing, and systematic way of obtaining independent assurance that the policies of the board are implemented by management. IA's assurance services

may help the board reduce downside risk, whatever the risk type, and may move beyond compliance to address the downside of performance risks as well (Ernst and Young 2006a, 18). With assurance services to the oversight body (board/audit committee) as the core business, IA may consider the suggestion by Deloitte (2007), which describes the role of IA as "reassurance" since it is management's responsibility to lead the enterprise, which includes ensuring that risks are appropriately addressed. That nuance is more than semantics, as it helps to clarify the division of labour between accountability (management) and oversight authority (board/audit committee). As the oversight authority and management typically have different incentives, risk tolerances, and concerns, they also have different views about the fundamental purpose of IA.

At present, there is no straightforward single answer to the question concerning what is the added value and what is the fundamental role of IA. The glossary to the IIA Standards 2009 (IIARF 2009, 40) defines added value as *"improving opportunities to achieve organizational objectives, identifying operational improvement, and/or reducing risk exposure through both assurance and consulting services"*. However, another publication from the IIA (IIA 2010b) subsumes the value proposition of IA to that of *"a catalyst for improving an organization's effectiveness and efficiency by providing insight and recommendations based on analyses and assessments of data and business processes"*, or *"an independent source of objective advice with commitment to integrity and accountability providing value to governing bodies and senior management."*

The perspective that matters most has not been clearly defined because IA does not have a clear chief stakeholder/"boss", so IA means different things to different people, contributing to the perspective viewing IA as "jack of all trades", in other words "a master of none" (Burns *et al.* 1994, 112). The IIA may involuntarily contribute to that construct of vagueness when it positions IA to accommodate a variety of contingencies: acknowledging, for example, that countries, organizations, and audit activities are at different levels of maturity, that management in different organizations has different expectations, and that the services offered by IA vary greatly (IIA 2010c). That variety means that there is no one meaning of the fundamental role of IA. Consequently, Garnett (2010) questions the Unique Selling Proposition (USP) of the IA profession, a fundamental concern, as leveraging a service that makes a difference (Bateson 1990) is required when creating an identity. In the absence of such a USP, openly or implicitly

claiming to be an expert in everything is likely to remain unrewarding since an expert in everything, when unmasked, will reveal itself as an expert in nothing.

The aspiration to broaden the scope of IA beyond the assurance arena may not be helpful in establishing IA as a profession, as doing so may move IA farther away from what matters most to boards and audit committee (Baker 2003, Deloitte and IIA UK and Ireland 2008, Ernst & Young 2006a), the potentially most important stakeholders tasked with the overarching responsibility of risk oversight (ICGN 2010, 5). The IIA UK and Ireland is pointing out that IA focuses on all categories of risk, is ongoing and ideally forward-looking (House of Lords 2010, 168). Such "progressive assurance" (Piper 2011, 13), forward-looking and ongoing assurance evaluating and improving the effectiveness of risk management, control, and governance processes - is the business IA claims to be in (IIARF 2011a, 2). Interestingly, while Practice Advisory 2050-2 suggests to perform assurance mapping, thus providing a holistic assessment and perspective, and the board is seen as increasingly asking who is providing assurance, where is the delineation between the functions, and if there are any overlaps (IIARF 2011a, 113), a survey in the UK revealed that only 8 percent of organizations participating in the survey have such a combined assurance program in place (IIA UK and Ireland 2010b, 6). And, many organizations have run into difficulties with their assurance mapping efforts (Paterson 2011, 14). Thus, there is significant room for improvement for IA in the arena of assurance, which is to be exploited, otherwise other professions may fill the gap, e.g., external audit firms already offering advice and consulting services when aspiring to establish combined assurance. Combined assurance may increase the quality of IA activities and positively influence the overall organizational governance (Sarens *et al.* 2012).

Clearly defining the core business of IA and concentrating on what matters most to who matters most may prove rewarding. Whilst there may not be one answer for all specific organizational context, considering to service the chief stakeholder best and first (it is suggested that to be ideally the board/audit committee), and narrowing but deepening the value proposition in the arena of assurance service at the expense of consulting services is the suggested path forward. Clarifying the customer dimension and the core business of IA is expected to help the IA profession when seeking universal recognition.

5. Conclusions, latest changes in the IIA Standards, and future research directions

The marginalized role of IA in the aftermath of the financial crisis that began in 2007 serves as the starting point of this paper. The absence of IA from the governance debate has been marked. The relevance of internal auditing has become a contentious issue in practice. When having no one clear boss and no single clear role IA is exposed trying to be many things to many people to the point where no-one is really sure who it is for and what it delivers. The analysis suggests that, to become a more relevant stakeholder in the corporate governance arena, the IA profession should consider clarifying both the perspective and the purpose of IA, that is, determining to whom IA should be accountable (the perspective from which its added value is judged) and clarifying/concentrating the IA's service offering (its purpose).

The Institute of Internal Auditors (IIA), the globally recognized standard setter of IA practices, may consider further reflecting upon the pros and cons when re-focusing the IA profession predominantly on assurance services, possibly progressive assurance services, ongoing and forward-looking, on governance, risk management, and control processes in order to more clearly contribute to increasing the long-term value of the organization it serves. More clearly stress the primacy of assurance service would give lower priority to consulting services. Consulting services would then be subordinated to assurance service and expected to support the latter. Filling the assurance vacuum (Chambers 2008) remains a prominent but unmet need (Baker 2003, Deloitte and IIA UK and Ireland 2008 and Ernst & Young 2006a). The two key conclusions of this paper are summarized below:

A. Positioning IA as agent to the board/audit committee and, at the same time, as partner to management is challenging in practice. The IA function should clarify the customer dimension in its organizational context. This is expected to help the internal audit functions demonstrating their value more clearly, also.

B. Assurance and consulting may be a confusing combination in practice that dilutes the value proposition. Consolidating IA around its core function of providing assurance is argued.

There are ambiguous signals in the latest revision of the IIA. On the one hand, e.g., Performance Standard 2010.C1 (IIARF 2011a, 27) requests the CAE to accept consulting

engagements that improve management of risks, add value, and improve the organization's operations. Thus, the potential tensions between the assurance and consulting role of IA are maintained. On the other hand, there may be subtle indication that the IIA is moving cautiously in that direction, as there is a trend towards moving the reporting lines of IA into the board; and the IIA is deemphasizing the role of consulting services when defining "added value":

In both recent revisions of the International Professional Practice Frameworks (IIARF 2009 and 2011a), in the IIA Standards 2009 (when adding Attribute Standard 1111), and in the IIA Standards 2011 (when revising the interpretation of Attribute Standard 1110), the IIA seems to be positioning the CAE closer to the board as an 'agent of the board', but doing so without abandoning the CAE as a 'partner to management'. Whilst there was no change to the Attribute Standard 1110 (organizational independence), the revised interpretation of this standard states that organizational independence is most effective when the CAE reports functionally to the board. This interpretation gives for the first time explicit examples of what that means in practice. With this revision in the interpretation section of the standards effective since January 2011, the IIA has further heightened the significance of the reporting line to the board. However, the IIA continues to consider that IA is sufficiently independent (and capable of providing independent assurance to the board) when it reports functionally to the board and administratively to management (Chambers 2010).

Furthermore, the concept of "added value" has changed when comparing the IIA Standards 2009 with its latest version effective since January 2011 (IIARF 2011a). "Added value" is now referred to in the statement: *"The internal audit activity adds value to the organization (to its stakeholders) when it provides objective and relevant assurance, and contributes to the effectiveness and efficiency of governance, risk management and control processes."* Thus, the newest definition of "added value" emphasizes (1) the perspective of the organization's stakeholders (without being more explicit), and (2) the delivery of assurance services (thereby de-emphasizing consulting services), and (3) contributions to effective and efficient governance, risk management, and control processes. The inclusion of efficiency as a category is new since it is not included in the IA definition, and this discrepancy points to some misalignment. The sequence has changed, too; governance processes come last in the IA definition, they

come first when “added value” is defined, which may acknowledge the expected increased importance of governance processes in practice (IIARF 2011e, 47).

Corporate governance reviews ranks top on list of activities internal auditors expect to perform in the next five years, followed by audits of the enterprise risk management process, so practitioners believe that these two areas are going to become (or have already become) important cornerstones of their profession - noting that this aspiration already existed in 2006 (IIARF 2011e, 22 and 38). As practitioners expect to become more involved e.g. in strategy development and anticipate to put less emphasis on assurance (IIARF 2011e, 24), it is worth noting that the internal audit activities in countries where the IA profession is more established like in the US, Canada and Western Europe are less ambitious when it comes to extending their activities to having an advisory role in strategy development (IIARF 2011e, 63). This paper suggests IA to rather “stick to its knitting”, and is advocating the primacy of assurance services versus consulting services as a better avenue when seeking to establish IA as a profession. It is suggested to the IIA to consider positioning IA more clearly as provider of progressive, i.e. future oriented, and continuous assurance services rather than forcing the internal audit activity into strategy consulting services which may be farther away from its comfort zone and competence level. Such re-focus on assurance services that include controls, also governance and risk management, may be advantageous when aspiring in practice to eventually more fully live up to the claims made in the IA definition (IIARF 2011a). In that sense the suggestion of this paper clearly challenges the mainstream, as it is advocating a different direction most internal audit activities are currently going.

Future directions for research could include:

1) The motivation and impact of the recent changes of the International Professional Practice Framework (IIARF 2011a) that emphasize the reporting lines of IA to the board. That move may signal a strategic and lasting change of direction or simply a tactical and temporary reaction to what happened during and after the financial crisis that began in 2007.

2) The implications of possible tensions with senior management if IA reports straight into the board or the audit committee and IA so becomes fully the agent of that oversight body, whilst abandoning the reporting link into management.

3) As it is currently expected that the audit committee or equivalent determines, on behalf of the organization, an explicit strategy for finding the right balance between assurance services and consulting engagements to be provided by the IA function, further study on this process to clarify what "balance" precisely means and how it is found in practice.

4) An investigation of the impact of the 8th European Directive (Directive 2006/43/EC, Article 41) on the audit committee and its role in the governance arena, and the opportunities (and risks) the directive entails for IA. The directive requests that each public-interest entity in the European Union have an audit committee tasked to monitor the effectiveness of the company's internal control, internal audit (where applicable), and risk management systems. Such a study could compare the impact in various member-states of the European Union.

5) A study of the concept of IA as a credence good with particular focus on assurance services as an activity and as an outcome in order to clarify the "product" IA offers and explore how to improve its value proposition for its key stakeholders (e.g., via combined assurance).

6) A study of the alternative concepts of and ways to strengthen the role of IA in corporate governance codes by exploring the pros and cons of making IA mandatory, as it is in the NYSE listing requirements.

7) An investigation of the comparative limitations and opportunities of different governance environments on the role of IA, with a particular focus on the similarities and differences between a one-tier board structure (like those in the US and the UK) and a two-tier board structure (like e.g. in Germany).

8) A contribution to the limited studies on IA effectiveness that includes research on corporate governance disasters and an exploration of what an effective IA function could have done differently in those cases.

9) An investigation of the impact IA currently has and could have on board effectiveness. This means integrating two streams of research, IA effectiveness and board effectiveness.

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PAPER 4

TESTING THE DISCRIMINATORY POWER OF CHARACTERISTICS OF INTERNAL AUDIT FUNCTIONS: SORTING THE WHEAT FROM THE CHAFF

Abstract

Purpose – The literature suggests that among Internal Audit function's (IAF's) there are different levels of effectiveness. The purpose of this paper is to examine the characteristics of an IAF that help to distinguish two groups of IAFs, which may point to different levels of effectiveness. This is supplemented by conceptual considerations as to what constitutes Internal Audit (IA) effectiveness.

Design/methodology/approach – This study, based on a survey of 46 Heads of IA (CAE) in private organizations in Germany, tests whether the IAF characteristics suggested in the academic and practitioner literature can differentiate between IAFs.

Findings - This study distinguishes different groups of IAFs, which may point to different levels of IA effectiveness at both ends of the range, as the different characteristics may be associated with comparatively more and less effective IAFs. The multi-faceted concept applied to the study data to sort the wheat from the chaff has four dimensions: organizational characteristics, IA resources, IA processes, and the pattern of relationships between the CAE and key governance stakeholders. Discriminatory characteristics and features identified through the study include: the existence of an IA charter that is agreed by the board/audit committee (AC), the extent of possibilities for career progression after tenure in IA, the degree of co-sourcing and outsourcing of IA services, the level of training and professional qualification of IA staff and CAEs, the use of IA technology and risk-based IA, whether IA makes recommendations for improving the governance process and rates individual findings and grades the overall report, whether the CAE has appropriate access to the board/AC, whether the CAE benefits from senior management's (SM) and the board/AC's input to the IA plan, and the CAE's informal contact with SM.

Practical implications - This study provides pointers that may help CAEs who want to enhance the effectiveness of their IAF.

Originality/value - This study provides a tool that highlights the differences between IAFs, which may point to underlying different levels of IA effectiveness.

Keywords - Internal auditing, self-assessment, characteristics, discriminatory power, effectiveness

Paper type – Empirical survey

Introduction and research question

While IA effectiveness continues to be actively debated in practice (e.g., Deloitte, 2010; Ernst & Young, 2006, 2008, 2010, 2012; KPMG, 2009; PwC, 2009, 2010, 2012), it is an enigma and largely viewed as an underexplored 'black box' in academic research (e.g., Anderson, 2003; Arena and Azzone, 2009; Cohen and Sayag, 2010; Hermanson and Rittenberg, 2003; Paape, 2008; Prawitt, 2003; Sarens, 2009). This study sheds some light on that 'black box' and enriches the associated body of knowledge by suggesting possible indicators of IA effectiveness. The paper builds on the assumption as suggested by literature that there are different levels of IAF effectiveness.

The central question of the paper concerns whether, and to what extent, the data generated exclusively by a questionnaire and based on the self-assessment of CAEs have discriminatory power to distinguish two groups of IAFs that may point to differences between the comparatively strong and effective IAFs and the comparatively weak and ineffective ones. Therefore, the research question (RQ) addressed in this paper is:

To what extent does applying the set of characteristics of IAFs suggested by practitioners and academic research help differentiate between IAFs and point to the allegedly rather strong and effective IAF in contrast to the rather weak and ineffective IAF?

This paper consolidates various dimensions that can signal IA effectiveness and it makes transparent the differences in practice helped by questions that have discriminatory power. As the applied model enables to see relevant differences between IAFs, this paper may provide an IA effectiveness mosaic and the seeds for a theory of IA effectiveness. The questions are based on indicators suggested by a literature review and derived from academic and practitioner sources, complemented by some novel considerations. While most test variables employed in the research are suggested by the literature, this study is normative as we associate certain IAFs characteristics with comparatively higher or lower IA effectiveness thereby disclosing our implied concept of 'what good looks like'. The stakeholders' perspective on the items measured is not included because of the study design, so we do not directly measure IA effectiveness in this paper.

In order to address the RQ, a questionnaire was sent in the autumn 2010 to 134 CAEs of organizations headquartered in Germany. The response rate of 34 percent was comparable to other survey-based studies in the IA literature.

Given the source of the data, we acknowledge the specific German corporate governance context (German Corporate Governance Code, 2010) that is characterized by two-tier board structures with a management board (Vorstand) and a separate supervisory board (Aufsichtsrat). In Germany, senior management (SM) is generally regarded as the chief stakeholder of IA as it is common practice for the CAE to report directly to the management board ('Vorstand' or 'Geschäftsführung' depending on the type of legal entity), while the CAE may or may not have direct access to the supervisory body ('Aufsichtsrat' or 'Beirat') or a sub-committee thereof (Günther and Gonschorek, 2008: 139; Hölscher and Rosenthal, 2011: 489; Velte, 2011: 575), such as the audit committee (AC). The relevance of the survey is not limited to Germany or corporate governance regimes that have two-tier board structures as most IAFs have room for improvement, that is, 80 percent can do better according to Ernst & Young (2012: 1), and because the board/AC generally has an interest in benefitting from an effective IAF.

The paper is structured as follows: Section 1 provides conceptual considerations on what constitutes IA effectiveness. Section 2 presents the applied reference model and its four building blocks. Section 3 discusses the snapshot questionnaire that underpins the four building blocks. Section 4 describes the process of data collection. Section 5 presents the findings. Section 6 discusses the results. Section 7 acknowledges limitations of this research. Finally, section 8 summarizes and concludes, and suggests avenues for further research.

1. Conceptual considerations of what constitutes IA effectiveness

Before examining possible indicators of and what may increase IAF effectiveness, we provide some theoretical consideration of what constitutes it. This is quite a challenging question since there is no generally accepted definition of IA effectiveness.

Effectiveness, particularly IA effectiveness, is not self-explanatory; it means different things to different people. Bender (2006) points out that audit quality is not directly observable except in the event of an audit failure, so it is relatively easy to see only in hindsight when an audit was not effective. Auditing is a credence good (Causholli, 2009), that is, the audit customers cannot discern the quality of the good even after purchasing and consuming it. IA effectiveness is an enigma; the 'criteria of effectiveness are opaque' (Power, 1997: 10).

We suggest viewing IA effectiveness as a 'risk based goal-attainment concept that helps the organization to achieve its objectives' (Lenz *et al.*, 2012). IA is typically regarded as effective when it helps organizations achieve their objectives (Chambers, 1992), so there is no IAF without a business. Modern IA is risk based (Spira and Page, 2003); the IIA performance standard 2010 (IIARF, 2011a: 26) demands risk based internal auditing. When something is 'effective', it is adequate to accomplish its purpose and to ensure 'the achievement of a desired condition' (Dittenhofer, 2001: 445). Thus, in practice the resulting change serves as criterion, the specific outcome and (possibly) the lasting effects of the desired improvements that relate to a relevant and important area/process. In other words, an IA report as an output cannot be effective *per se* but may trigger intended change.

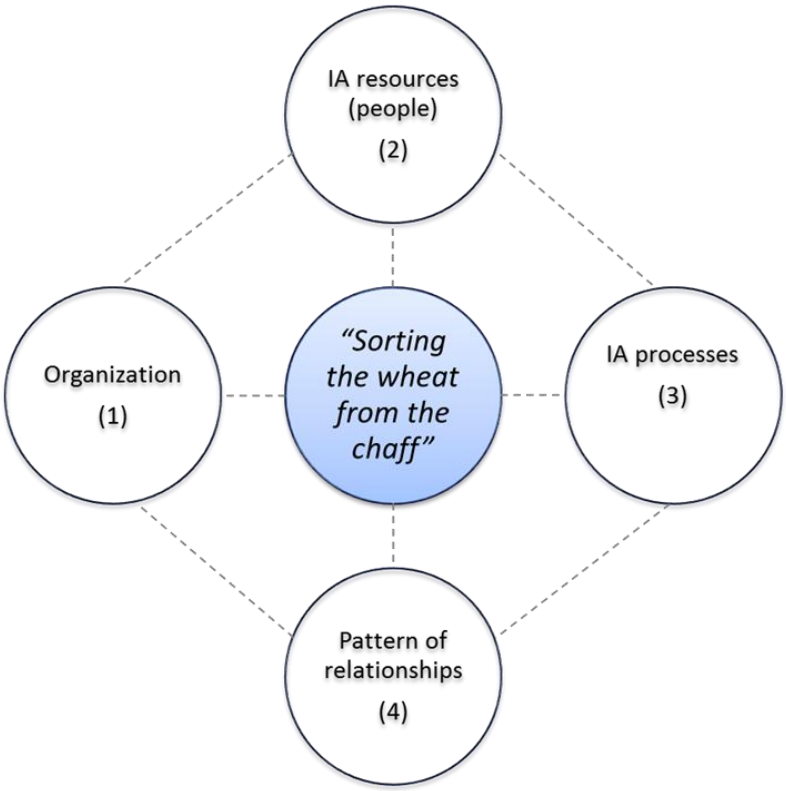
We select input, process, and output, complemented by organizational and relational indicators when examining the hazy phenomenon of IA effectiveness. Gramling and Hermanson (2009) wonder whether we would recognize IA effectiveness if we saw it, suggesting that indicators of IA effectiveness should include measures of input, processes, and output. These dimensions comprise elements like, having the right people with adequate skills and personal qualities (input factors), applying appropriate procedures, technology, and techniques (process factors) and consider the usefulness of the deliverables, i.e., the IA reports and recommendations (output factors). Arena and Azzone (2009) show that IA effectiveness is influenced by the resources and competencies of the

IA team, the processes and activities of IA and organizational and relational factors. We build on this. Due to the study design this survey is exclusively based on the self-assessment of CAEs, thus, we disregard stakeholders' perspectives, so output and relational factors will only be studied to some extent and from the perspective of CAEs. Based on a literature review, relevant questions are clustered into four building blocks.

2. The reference model has four building blocks

Figure 1 shows the factors (building blocks) that were derived from the literature review.

Figure 1: Clustering of IAF characteristics/items



Our reference model has four building blocks in which we cluster the set of characteristics that may allow us to separate two groups of IAF that look significantly different, to sort the wheat from the chaff:

- Organization,
- IA resources (people),
- IA processes and

- Pattern of relationship (with key governance stakeholders).

The building blocks are expected to be related and inter-connected, as suggested by dotted lines. For example, a competent and professional CAE may be more likely to establish sound IA processes and to build beneficial relationships with other governance actors, namely SM and the board/AC. However, their relationships are not the focus of this paper.

3. The snapshot questionnaire that underpins the four building blocks

The questions (Appendix A) are clustered into four building blocks and tested individually.

3.1 Reference model, building block number one: organizational characteristics

Organizational characteristics, such as firm size, the overall governance context, and whether the organization has a legal requirement to establish an IAF, are considered as differentiators that can affect IA effectiveness (Carcello *et al.*, 2005; Goodwin-Stewart and Kent, 2006; Sarens *et al.*, 2011; Sarens and Abdolmohammadi, 2011). Questions concerning the IA role and mandate are part of this building block.

We seek to distinguish two groups of IAF by testing if the:

- overall Corporate Governance context is strong or very strong (Q4),
- IAF is a legal requirement (Q5),
- IAF budget in the past two years has been unchanged or increased (Q6),
- IAF budget for the coming two years will be unchanged or increased (Q7), and
- requirement for an IA charter is agreed upon by the board/AC (Q8).

When self-assessing the overall corporate governance context (Q4) within their respective organizations, respondents were prompted to consider dimensions like ethical values, risk and control awareness, risk management and internal control, and the tone at the top.

The relevance of legislative forces (Q5) on the development of IA is supported by Arena *et al.* (2006) who study IAFs in Italy, referencing, for example, the influence of the

legislative decree 231/01 (Italy) and the Sarbanes-Oxley-Act in the United States of America (US).

Money matters, so the funding of the IAF is regarded a differentiator. We view a flat or increased budget (Q6 and Q7) in contrast to reduced funding as a differentiator to separate two groups of IAFs, which may be an indicator of IA effectiveness, because the availability of funds may signal SM's and the organization's appreciation of IA. In addition, such funds offer, for example, the opportunity to hire and keep qualified staff, and complement the in-house IA work by buying in some services as needed (provided the money is spent wisely).

IAFs that do not have a written IA charter (Q8) will likely warrant an unsatisfactory rating in quality assessment, as a written charter is regarded as a minimum requirement (DIIR, 2007).

3.2 Reference model, building block number two: IA resources (people)

The characteristics of the IAF as a whole and the characteristics of the individual auditor are components that affect IA effectiveness (Sarens, 2009). Van Peursem (2005) views communication skills and personal authority as indicators of successful internal auditors who define their role by adapting and tailoring it to circumstances. Rittenberg and Anderson (2006) present the ideal profile of a skilled and qualified CAE referencing, for example, stature and presence, strategic audit focus, the ability to exercise sound judgment, and the capacity to communicate clearly on audit issues.

Some of the questions grouped in this block are self-explanatory and standard, like questions on training and professional IA qualifications, and some are developed as novel ideas to be assessed and tested.

We seek to distinguish two groups of IAF by testing if the:

- average tenure of IA staff in the IAF ranges from three to seven years (Q9),
- next career move of IA staff is usually a lateral move or a promotion (Q10),
- combined share of co-sourcing and outsourcing of IA services ranges from 1 percent to 40 percent (Q11),

- IA staff has 40 hours or more of training per year (Q12),
- IA staff are trained on at least two of the dimensions of governance, fraud and ethical audits (Q13),
- tenure of the CAE in its current role ranges from three to seven years (Q14),
- CAE has worked in senior positions outside IA (Q15),
- CAE has a professional IA qualification (Q16),
- IA staff are required to have a professional IA qualification (Q17) and
- CAE participates in at least two networking activities with IA peers (Q18).

This block contains some considerations that have not yet been supported by academic research. According to PwC (2012: 31), the most innovative IAFs have formal staff rotation programs; that is a significant percentage of their staff come from the business and return to the business. Q9 and Q14 refer to the idea that freshly appointed IA staff and CAEs must first get to know the organization before being fully operational and reaching, at some point, the peak performance level from which effective IA services are rendered. It is assumed that typically there is a turning point after which the threats to objectivity like self-review, social pressure, economic interest, personal relationship, and familiarity (Mutchler, 2003: 251), may present a heightened risk for internal auditors that gradually becomes less well mitigated. Internal auditors (including the CAE) who continue in a position in the same organization for too long may be at risk of losing value and their cutting-edge abilities. The optimal span of time in the job is viewed in the snapshot questionnaire to range from three to seven years.

Q10 presents another consideration, which postulates that career prospects affect career choices when IA staff leave the IAF but continue to work for the same organization. If the next career move in the same organization is typically a demotion, it is unlikely that the IAF in the organization attracts the best individuals. Burton *et al.* (2012) find in an US experiment that experienced internal auditors have higher interest in applying for an IA position when the position advertises a short stint in IA and then promotion into management positions.

The majority of IAFs may not be using any co-sourcing or outsourcing (IIARF, 2010a: 29). Q11 presents a consideration that builds on Rittenberg and Covaleski (1997) and suggests that in the long end neither zero co-sourcing nor is full outsourcing an optimal solution to exploit the potential power of IA. PwC (2012: 32) observes that many IAFs struggle to deliver specialist expertise that is required when effectively auditing areas such as large program risks (e.g., when implementing an Enterprise Resource Planning software), and many IAFs allow those constraints to limit their focus. Ernst & Young (2010: 9) suggest that co-sourcing arrangements are essential for successful IA departments.

Q12 is based on training requirements (IIARF 2010a: 11) postulated by the Institute of Internal Auditors (IIA) that requires practicing CIAs (Certified Internal Auditors) to have on average 40 hours per year of continuing professional education (CPE). Barma (2006: 30), among others, concurs with this view and concludes 'the best internal audit functions I have worked with are continuously looking to be innovative and improve the way they work.'

As the IA activity does not contribute to governance to the same extent as it does to controls (IIARF 2011b, 5) possibly because these audit subjects are viewed as particularly demanding, adequate training to perform governance, fraud and ethical audits (Q13) can be helpful and may increase the chance that internal auditors deliver more and better.

Q15 is linked with another reflection. This is the expectation that internal auditors, who have senior level experience in areas outside IA, are regarded as a premium asset as they have experience with the roles and responsibilities of those they are supposed to review and audit. This view is supported by Brodie (2010: 26) who, among others, reports that *'one of the greatest assets that any internal auditor can have is the ability to step into clients' shoes and see things from their perspective'.* Thus, it is reasonable to assume that such experience will be helpful in developing an appreciation of the subject matter, and may help in gaining acceptance from the auditee.

Professional qualifications for CAEs (Q16) and IA staff (Q17) are generally regarded as helpful. According to Myers and Gramling (1997), for example, the Certified Internal Auditor (CIA) designation is perceived to be indicative for a significant level of competence and to provide career advantages in IA positions. Abdolmohammadi (2009)

recommended that the IIA emphasize the certification of membership, as, currently, anyone can sign an IA report, even those with no IA designation. That may be worth considering for the IIA.

We view networking activity (Q18) as a potential differentiator between CAEs because discussing IA practices and challenges with peers and learning from their perspective are regarded as opportunities to improve. Being appreciative of the plurality of practice may be a good guide for continuously improving the own IA activity.

3.3 Reference model, building block number three: IA processes

The top five tools used in practice (IIARF, 2009: 12) when self-monitoring IA performance are compliance with the audit plan (i.e., the number of audits planned versus the number executed); compliance with a budget; a satisfaction survey from auditees; audit time management (planning, fieldwork, closing); and reporting time management (i.e., planned versus actual reporting time).

This list of tools largely corresponds with the measure of success referenced by Pforsich *et al.* (2006: 29) when establishing an effective IAF. In addition, the 2010 study of the Common Body of Knowledge (CBOK) ranks the percentage of the audit plan completed in 'pole position' (IIARF, 2011b: 40). The criteria that are used in practice are not further critiqued in this paper, as the practical relevance and usefulness assumed by practitioners are viewed as justification for inclusion in the questionnaire.

The IIA International Professional Practices Framework (IIARF, 2011a) provides mandatory guidance to internal auditors that describe the role model for the IAF to follow and how an IAF should work. The definition of IA (IIARF, 2011a: 2) represents the mission statement, the declared purpose of IA. There are known gaps in practice, such as compliance with the Attribute Standard 1300 (Quality Assurance and Improvement Program) as only about a third of CAEs claim full compliance (IIARF, 2010a: 31). The 2007 guideline for conducting a quality assessment (DIIR, 2007) consists of eighty-one questions clustered into eleven observation areas, summarized under three headers: the so-called 'basics' of IA (organization, position within the company and responsibilities, and budget and planning), the audit process (preparation, execution, reporting, post audit work and follow-up) and staff (selection, development/training, and management of the IAF). Five minimum standards are highlighted (DIIR, 2007: 6): having a charter,

independence, risk-oriented planning process, documenting results and implementation of a follow-up process. As adherence to these minimum standards is considered essential, non-adherence to any one of these five criteria would result in an unsatisfactory rating. Consequently, those minimum criteria are included in our reference model that may proxy an IA effectiveness model.

With the above features and matters in mind, we seek to distinguish two groups of IAF by testing if:

- the IAF is using Computer Assisted Auditing Techniques (CAAT) (Q19),
- an external quality assessment was performed in the past five years[1] (Q20),
- risk-based IA is applied to determine the priorities of the IA activity (Q21),
- assurance mapping is used to identify assurance providers for key risks (Q22),
- an assessment of the reliability is performed of the assurance provided by others (Q23),
- SM provides input to the IA plan (Q24),
- the board/AC provides input to the IA plan (Q25),
- IA makes recommendations for improving the governance process (Q26),
- IA evaluates the effectiveness of risk management (Q27),
- final IA reports are published within two weeks after completion of the audit (Q28),
- IA rates individual findings and grades the overall IA reports (Q29),
- IA follows-up on the status of issues a minimum of three times per year[2] (Q30),

[1] Attribute Standard 1312 (External Assessments) requires a qualified, independent review from outside the organization to be conducted at least once every five years (IIARF, 2011a: 23).

[2] Practice Standard 2500 (Monitoring Progress) requires the CAE to establish a follow-up process to monitor and ensure timely remediation of issues (or that SM has accepted the risk of not taking action).

- 90-100 percent of IA findings are implemented in a timely manner (Q31) and
- IAF uses a minimum of three measures of IA effectiveness not including ‘reliance by external audit’ (Q32).

Question 19 acknowledges that exploiting technology may be instrumental in improving IA effectiveness. Technology can help to automate the process of monitoring risk controls and can save time and resources (Bechara and Kapoor, 2012). Continuous risk and control assurance requires automated testing and continuous monitoring in order to comfort stakeholders that the significant risks are managed and that related controls are operating effectively (Marks, 2009).

Performance Standard (PS) 2010 (Planning) requires the CAE to establish risk-based plans to determine the priorities of the IA activity, consistent with the organization’s goals (IIARF, 2011a: 26). Resources are scarce and time is easily wasted if IA looks at the wrong matters, so a risk-based IA generally helps the CAE and IA staff to focus on what matters most. The importance of risk-based IA is supported by the literature (e.g., Allegrini and D’Onza, 2003; Burnaby and Hass, 2009; Spira and Page, 2003; PwC, 2009). The concept of risk-based IA has been the subject of position papers (IIA, 2009; IIA UK and Ireland, 2005a), complemented by professional guidance when implementing (IIA UK and Ireland, 2005b). Questions 24 and 25 also relate to Practice Standard 2010 (Planning), by which the CAE is requested to consult with SM and the board when developing a risk-based plan (IIARF, 2011: 26-27).

Practice Advisory 2050-2 and 2050-3 3 (IIARF, 2011a: 113-122) suggest the performance of assurance mapping, thus providing a holistic assessment and perspective, and an assessment of the reliability of the assurance provided by others. As we suspect shortcomings in practice, we test our expectation by Q22 and Q23 in a German setting. A survey in the UK revealed that only 8 percent of organizations participating in the survey have a combined assurance program in place (IIA UK and Ireland 2010, 6).

Questions 26 and 27 are expected to have high discriminatory power, as there are relatively fewer IAFs that adequately evaluate and improve the effectiveness of risk management and governance processes (as demanded by the IA mission) compared with the IA contribution to controls (IIARF, 2011b: 5). Only about half of the IAF represented in the two recent CBOK studies play an important role in governance (IIARF, 2007: 55).

Similarly, CBOK 2010 reports that 55 percent of IAFs do not perform corporate governance reviews, and 68 percent perform no ethics audits (IIARF, 2010a: 25).

The speed of reporting is associated with quality and (potential) effectiveness, so IA reports that are issued soon after the fieldwork has been completed are viewed as a positive sign (Q28), 'observations related to fraud, waste, or abuse, for example, may require immediate attention' (Sparks, 2011).

Lin *et al.* (2011) showed, among other findings, that various IA activities help IA effectiveness, including the use of quality assurance techniques (Q20), grading IA reports (Q29) and performing follow-up (Q30) on issues securing remediation. In their US study, disclosures of material weakness emerge as positively associated with the IAF practice of grading audit engagements, suggesting that this activity increases the effectiveness of the Section 404 (Sarbanes-Oxley-Act) compliance processes when assessing the effectiveness of the internal control structure and procedures for financial reporting. As indicated by Holt and DeZoort (2009), an IA report can improve investor and other stakeholder confidence when it complements existing corporate governance disclosure, further enhancing the practice of IA report writing. Thus, rating findings and grading the overall report are features, which deserve attention by practitioners.

Ultimately, IA performs through others. Issues in IA reports must be remedied by the process owners and responsible staff. Regular follow-up is viewed as crucial, so the success rate of timely and effective remediation of issues is tested by Q31. The authors are aware of the limitation that the outcome of this question may be partly a consequence of other processes.

Q32 refers to an element that contains a novel reflection. Some view IA as subordinate to external audit – in the belief that IA acts as an assistant to the professional service provided by external audit. That discussion is typically subsumed into the 'reliance question' (Cohen *et al.*, 2007; Desai and Desai, 2010; Felix *et al.*, 2001, 2005; Gramling *et al.*, 2004; Krishnammoorthy, 2002). External audit's perspective is challenged, and an 'anti-reliance assumption' is developed in the next section.

3.4 Reference model, building block number four: pattern of relationships

The effectiveness of other governance actors (SM, the supervisory board, and the AC) is

also expected to affect IA effectiveness because the IAF is not an island. The 2010 practice guide on measuring IA effectiveness and efficiency (IIA, 2010) moves 'meeting stakeholders' needs' to center stage: sample measures of effectiveness include client satisfaction ratings, percent of recommendations implemented, and number of unsatisfactory internal audit opinions. The number of management requests is regarded as a criterion to measure service to stakeholders. All of these criteria (with the exception of the number of unsatisfactory internal audit opinions) are also included in the reference model reviewed here.

We seek to distinguish two groups of IAF by testing if the:

- CAE has a functional reporting line to the board or AC[3] (Q33),
- CAE has an administrative reporting line to either the CEO, the deputy CEO, the CFO or the company secretary[4] (Q34),
- CAE has appropriate access to the board/AC (Q35),
- CAE meets *formally* with the board/AC monthly or quarterly (Q36),
- CAE is contacted *informally* by the AC a minimum of three times per year (Q37),
- CAE has appropriate access to SM (Q38),
- CAE reports *formally* to SM quarterly (at a minimum) (Q39),
- CAE is contacted *informally* by SM minimum three to four times per year (Q40), and
- external auditors do *not* rely on the work performed by the IAF (Q41).

Q33 - 40 focus on the importance of the CAE's interactions with the board/AC and SM. Such relationships, when they are characterized by regular interactions and an open dialogue, are expected to aid the IAF's pursuit of effectiveness. Thus, IA effectiveness is expected to be influenced by its interactions with SM (Van Gansberghe, 2005; Mihret and

[3] The IIARF (2011a: 17) recommends that the CAE report functionally to the board in order to achieve organizational independence.

[4] The IIARF (2011a: 16) suggests a dual-reporting relationship.

Yismaw, 2007; Halimah *et al.*, 2009; Cohen and Sayag, 2010), and with the supervisory board and the AC (Rezaee and Lander, 1993; Anderson, 2009; and Barma, 2009).

In Germany, the CAE usually reports to a member of the SM team or is responsible to the entire SM team (Günther and Gonschorek, 2008: 139; Hölscher and Rosenthal, 2011: 489; Velte, 2011: 575). Direct reporting lines of CAEs to the supervisory board ('Aufsichtsrat') are not yet common in the two-tier board system in Germany. According to a survey by the German Institute of Internal Auditors (DIIR), 82 percent of CAEs in Germany report solid line to the CEO, to a member of the SM team, or to the entire SM team (Eulerich, 2011: 22). In Germany, SM is generally regarded as the 'boss' - the 'chief stakeholder' of IA, which reduces any uncertainty and ambiguity when IA 'serves two masters' (Anderson, 2003; Beasley *et al.*, 2009; Chambers, 2008; Deloitte, 2010; Hermanson and Rittenberg, 2003; IIARF, 2003; and Lenz and Sarens, 2012). Consequently, SM's appreciation of IA is an important enabling factor, as Geis (2010) determines in a study of the potential benefits of IA in the German context. Cohen and Sayag (2010: 304) see this relationship as more important than the qualifications and work setting of the IA staff because SM makes important decisions that affect IA, including hiring proficient IA staff, developing career channels for IA staff, and providing organizational independence for IA work. Additionally, some CAEs may benefit more from access to the board/AC than others also in the German setting.

Q41 is associated with PwC's survey (2009), which demonstrated that only 13% of IAFs participating in the study spent 25% or more of their resources on strategic and business risks, while these two risk areas are the prime causes of value destruction (60%), followed by operational problems (20%), and only 15% stem from financial risks and a mere 5% from compliance-related risks. The more the work of IA is related to the topics of external audit, the more appreciative external auditors become, however, as the external audit is financially oriented, its focus can be far removed from the areas in which IA can make a difference for the organization.

That view is supported by Arena and Jeppesen (2010), who conclude, 'IA will need to demonstrate that it is different from external auditing' and that 'the new focus of IA on risk management may legitimate the work of IA before public opinion.' This view builds on Spira and Page (2003), who suggest that risk management should become the central theme within both the conceptual world and practical work of IA. Thus, reliance on the

external auditor as an indicator of IA effectiveness can be dangerously misleading.

This perspective is an opposing view to the majority of existing empirical literature on IA effectiveness in terms of whether IA contributes to the financial statement audit (Cohen *et al.*, 2007; Desai and Desai, 2010; Felix *et al.*, 2001, 2005; Gramling *et al.*, 2004; Krishnammoorthy, 2002). CBOK 2006 shows that about 35 percent of IAFs that perform any formal assessment of value added used reliance on IA by external audit as a criterion (IIARF, 2007: 198).

In addition to the test variables identified above, we include considerations on the overall firm characteristics.

3.5 Overall firm characteristics

We study the demographic information of firm size and the industry sector. According to Carcello *et al.* (2005) and Goodwin-Stewart and Kent (2006) firm size is expected to be positively associated with effective IAF. According to Carcello *et al.* (2005) and Sarens and Abdolmohammadi (2011) the industry sector makes a difference to the investment in the IAF.

After presenting the rationale for the components and questions in our reference model that may proxy an IA effectiveness model, we next present the methodology applied for generating and analyzing the data, describe the outcome, and discuss what the data tell us.

4. Data collection

As this study is designed to work solely with questionnaire data based on the self-assessment of CAE, we do not consider other stakeholders' views.

When developing the questionnaire, we have attempted to define a set of questions that have discriminating power to obtain a spectrum of results, rather than having all responses narrowly clustered. The questionnaire benefitted from consultation with academics and from the suggestions of the coordinators of two working groups of German internal auditors: the German IIA working groups 'Rhine-Main area' and 'Mittelstand' (German mid-sized companies).

The questionnaire was first pilot-tested by the two coordinators of these German IIA

working groups, and in autumn 2010, a duly revised version of it was made accessible through 'Vovici EFM Continuum software.' The questionnaire was sent to CAEs in Germany, that is, to heads of IA in Germany that were members of the German IIA working groups 'Rhine-Main area' and 'Mittelstand'. In all, the two groups combined had 134 members at the time of the review. The questionnaire was open for replies for two weeks, and 46 valid responses were received for a response rate of 34 percent. This response rate is comparable to other survey-based studies in the IA literature. Carcello *et al.* (2005: 76) yield a usable response rate of approximately 25 percent, and Sarens' and Abdolmohammadi's (2011: 13) sample base represents 28 percent of that study's target population.

Non-response bias was tested using the Kruskal-Wallis test[5] to compare the responses of early and late respondents. By comparing the responses from questionnaires that were returned within the first week with those that were received in the second week, we were able to confirm that non-response bias is not a problem in this study.

The 46 sample cases are considered a fair representation of German IAFs that are members of the DIIR:

- In the sample base, the industrial sector stands out as that most frequently represented, with the major industries being manufacturing and engineering (28 percent) and health care, life science and pharmaceuticals (20 percent). About 60 percent of the sample firms have revenues below EUR 1.2 billion, and about 80 percent have staff that number fewer than 10,000.

- The above features correspond well with an IA survey on demographics in Germany where 65 percent of the participating firms report revenues below EUR 1.0 billion and 90 percent have staff that number fewer than 10,000[6], and with over 40 percent of the respondents operating in an industrial sector when adjusted for comparison (Eulerich, 2011: 11-14).

[5] Brosius (2011: 859, and: 880-881)

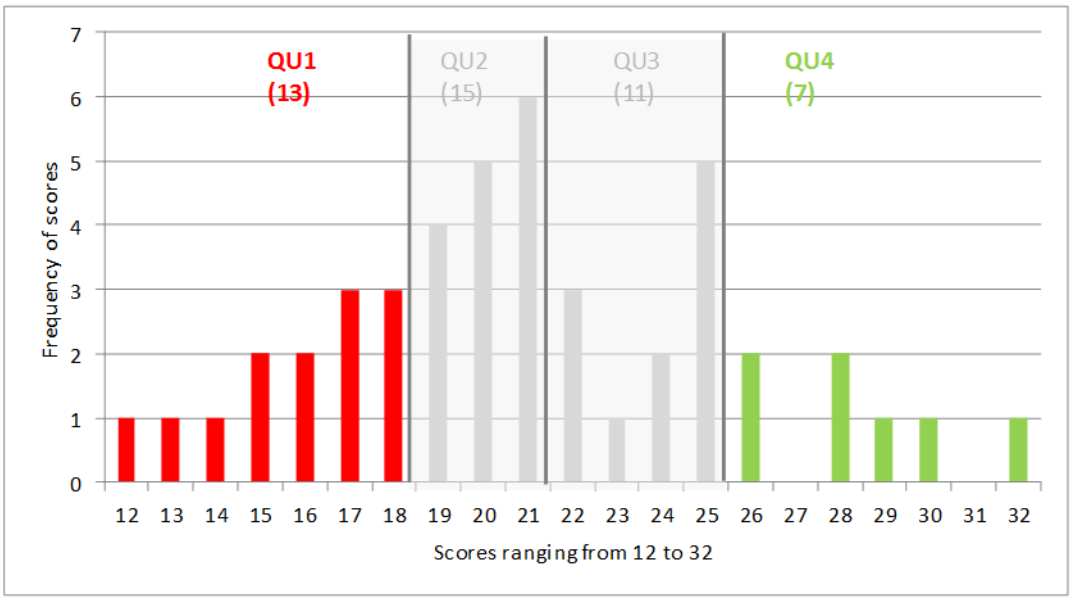
[6] In the sample, 7 percent have revenues exceeding EUR 6 billion and only 9 percent have staff that number more than 25,000. In the 2011 survey (Eulerich, 2011: 12, 14) 8.5 percent have revenues exceeding EUR 5 billion and 3 percent have staff that number more than 50,000.

Based on a diligent literature research we view this set of characteristics as an instrument to distinguish two groups of IAFs, which may be indicative for different levels of IA effectiveness. Subject to the answer to each question (Appendix B), one or zero points were scored, and the overall score was then calculated. The questions were not weighted in any manner. We argue that the binary approach is well suited for the purpose of this study as we only examine the extreme cases at the top and lower end of the range. The score is indicative only; our lenses are not discerning enough to see and interpret marginal differences. Any finer methodology would require identifying further questions to heighten discriminatory power to determine the meaning of any more subtle differences that may be observed. At the time this study was designed, we did not believe that a more refined measurement scale would reveal differences that we could measure and reliably interpret, such that this would make much difference in our findings.

5. Findings

With thirty-eight qualifying questions captured in the scoring model (Q4 to Q41), the maximum points that could be achieved was 38. The snapshot questionnaire created the spread of scores shown in figure 2.

Figure 2: Aggregate results of the frequency of scores per quartile



The highest score of all 46 responses was 32, and the lowest score was 12. Both scores appeared once. The median score of all 46 cases was 21, which appeared six times. The

first quartile (QU1) includes scores up to 18, and the fourth quartile (QU4) has a minimum score of 26. Thirteen cases are grouped in QU1, representing the bottom end of the range, and seven cases are clustered in QU4, representing the top end of the range. As the study intends to look into extreme cases, only the cases that are grouped into QU1 or QU4 are examined and studied further. A two-step process is applied to test the statistical significance of the dummy variables (1/0) (Brosius, 2011; Janssen and Laatz, 2010).

First, a cluster analysis is performed to test the suggested arrangement of cases into quartiles, thereby identifying which cases fit statistically well together based on their scores. The cluster analysis (Brosius, 2011: 711; Janssen and Laatz, 2010: 483) is based on an algorithm that minimizes distances *within* clusters while optimizing the distances *between* clusters. The squared Euclidian distance (Brosius, 2011: 738) is used in performing the cluster analysis of dummy variables by calculating the total number of disparate pairs of variates: the lower the score, the more the respective cases resemble each other; the higher the score, the more they differ. All 46 cases are assessed and sorted into clusters. The cluster analysis shows that QU1 and QU4 are distinct.

Second, cross tabulations (cross tabs)[7] are provided that give a picture about the interrelation of two variables, that is comparing QU1 with QU4 and the pattern of responses (0/1) per question in a 2x2 matrix per question. The Fisher's exact Test, that is recommended when cell values are small (Brosius, 2011: 429; Janssen and Laatz, 2010: 274) tests and validates which questions provide answers that are significantly different across the two cluster quartiles, such that they reveal statistically validated discriminatory power.

This analysis shows that the answers to some questions are significantly different ($p < 0.05$) between the clusters. The magnitude of Cramers V (= Phi) is then employed to demonstrate the strength of that connection. Cramers V ranges from 0 to 1 (Brosius, 2011: 433; Janssen and Laatz, 2010: 278). Cramers V greater than 0.2 are generally viewed as acceptable, and Cramers V of around 0.5 up to 0.8 (what we see here) are generally regarded as comparatively strong.

As shown in table 1, 14 questions are statistically significant to distinguish QU1 from QU4 with Cramers V ranging from 0.480 to 0.811.

[7] Brosius (2011: 415-445)

Table 1: Fisher's exact Test ($p < 0.05$) and crosstabs of the 14 questions with discriminatory power

							QU1 (n = 13)		QU4 (n = 7)	
#	Q#	Building block	Code	Issue underlying question	Fisher's exact Test	Cramers V (= Phi)	abs.	%	%	abs.
1	Q8	**Organization**	IA_C	IA charter exists and is agreed by the board/AC	**,044**	,480	7	54%	100%	7
2	Q10	**IA resources**	NEXT	Next move of IA staff is generally a lateral move or a promotion	**,022**	,538	6	46%	100%	7
3	Q11		CO_S	Combined share of co-sourcing and outsourcing of IA services is 1-40%	**,044**	,480	7	54%	100%	7
4	Q12		TRA_IA	Training of IA staff is 40 hours per year or more	**,022**	,560	2	15%	71%	5
5	Q16		Q_CAE	CAE has a professional IA qualification	**,031**	,572	0	0%	43%	3
6	Q17		Q_IA	IA staff are required to have a professional IA qualification	**,000**	,811	2	15%	100%	7
7	Q19	**IA processes**	CAAT	IAF uses CAAT (Computer Assisted Auditing Techniques)	**,000**	,811	2	15%	100%	7
8	Q21		RBIA	Risk-based IA is applied to determine priorities of the IA activity	**,044**	,480	7	54%	100%	7
9	Q24		SM_INPUT	Senior management provides input to the IA plan	**,022**	,538	6	46%	100%	7
10	Q25		AC_INPUT	Board / Audit committee provides input to the IA plan	**,001**	,787	0	0%	71%	5
11	Q26		IA_GOV	IA makes recommendations for improving the governance process	**,044**	,480	7	54%	100%	7
12	Q29		GRADE	IA rates individual findings and grades the overall report	**,044**	,480	7	54%	100%	7
13	Q35	**IA relationships**	IA-AC_1	Appropriate access to board/audit committee	**,010**	,599	5	38%	100%	7
14	Q40		IA-SM_3	CAE is contacted informally by Senior management, min. 3-4 times p.a.	**,022**	,560	2	15%	71%	5

We assume that such differences are associated with IA effectiveness. As we did not directly measure (perceived) effectiveness by asking SM or the board/AC whether (in their eyes) the IAF really helps to achieve the company's objectives, future formal research is needed to test this relationship.

6. Discussion of results

In this study, we identify some IAF characteristics that differentiate between IAFs. We can separate two groups of IAFs (QU1 and QU4) that look significantly different and we know which IAF characteristics made them different.

6.1 Fourteen questions with discriminatory power

6.1.1 IA charter exists and is agreed by the board/AC (IA_C, Q8)

While all IAFs in QU4 claim to have an IA charter (Q8) in place – one that has been agreed by the board or the AC, only 54 percent of cases in QU1 have established such an IA charter that clearly scopes the role and mandate of IA in their organization. The remaining 46 percent in QU1 may not have an IA charter at all, or they have one, which is not fully endorsed.

IAFs that do not have an IA charter, which clearly mandates the role of IA would get an unsatisfactory rating in a quality assessment on this basis alone, as having a charter is regarded a minimum requirement (DIIR, 2007). Further study of why some IAFs do not have such an IA charter would be useful. Such study may benefit the profession, and especially its membership of CAEs, by clearly emphasizing the 'basics' and ensuring that 'the five minimum standards' (DIIR, 2007: 6) are in place so the foundation according to the normative model represented by the international professional practice framework of the IIA (IIARF, 2011a) is right. More IAFs may have IA charters than are shown here, but the challenge remains to get them agreed by the boards or ACs or to understand the reasons why they are not.

6.1.2 Next move of IA staff is generally a lateral move or a promotion (NEXT, Q10)

Demotion as a next career move of IA staff is not reported to occur in the case of IAFs grouped in QU4. Such a career set back is reported in 46 percent of cases clustered in QU1. The statistical validation of Q10 supports the assumed vicious circle that only those IAFs that signal the possibility of promising career paths after some tenure in IA, have heightened chances to attract top performers who have a choice of alternative career options. Those IAFs in which a demotion typically follows a period in the IAF, may attract internal auditors who have limited or no alternative career options.

6.1.3 Combined share of co-sourcing and outsourcing of IA services is 1-40% (CO_S, Q11)

In 46 percent of cases in QU1, the IAF does not benefit from any co-sourcing. In all these cases, the IAF does not spend any money on professional service providers. That contrasts

with QU4, where all cases have a share of co-sourcing that ranges from 1-40 percent. IA's knowing its own limitations is regarded as positive, so some kind of balanced approach is regarded as favorable, such as using co-sourcing (cost) effectively where there is, for example, a lack of expertise and competency or a major transformational project that requires special attention. The threshold of 40 percent co-sourcing or outsourcing is chosen somewhat arbitrarily, but it is deliberately set below 50 percent, as the lion's share of the IA work (according to that assumption) should be provided by in-house capacity that has learned to navigate within the political context of the organization and will have an appreciation of its culture. The absence of any spending on professional service providers emerges as a helpful differentiator. Such a pattern may be indicative of the less effective IAF.

6.1.4 Training of IA staff is 40 hours per year or more (TRA_IA, Q12)

Eighty-five percent of IA staff in cases clustered in QU1 receive fewer than 40 hours of training per year (TRA_IA, Q12), while in stark contrast 71 percent of cases in QU4 have at least 40 hours of training per year. The differences between QU1 and QU4 in the dimension of training and continuous learning have statistically valid discriminatory power, which confirms Ridley's (2008: 246) leading paradigm that 'the aim [of success] should be to improve.' Investing or not investing in training of IA staff distinguishes the strong and effective from the weak and ineffective IAFs. Learning and remaining humble, that is, an IAF knowing its own limitations is viewed in a positive light. The 'know it all' attitude of those who lack such perspective is likely to backfire in practice. This study confirms that there is value in investing in training for IA staff since the return is likely to be that internal auditors are more effective than they would be without adequate training.

6.1.5 CAE has a professional IA qualification (Q_CAE, Q16)

Not a single CAE in QU1 is qualified as an internal auditor and only 43 percent of the CAE in QU4 have an IA designation (Q16). Having a CAE with or without a professional IA qualification emerges as a differentiator between the IAFs grouped in QU1 and those in QU4. As only a minority of CAEs in QU4 is qualified this observation poses directional questions about the value of the educational content and perceived value and benefit of such IA qualifications and designations for the most senior audience in the IA profession, that is, the CAEs.

6.1.6 IA staff are required to have a professional IA qualification (Q_IA, Q17)

All CAE in QU4 state that internal auditors in their respective team are required to have a professional IA qualification, but only 15 percent of those in QU1 state the same. The CAEs in QU4 appreciate the value of IA qualifications for their staff, so they stress them. The divergent emphasis on professional certification for IA staff serves as another statistically valid differentiator that can be indicative of different levels of IA effectiveness, potentially helping to sort the wheat from the chaff.

6.1.7 IAF uses Computer Assisted Auditing Techniques (CAAT, Q19)

Only 15 percent of cases in QU1 utilise technology, but all IAFs in QU4 apply Computer Assisted Auditing Techniques (CAAT). Technology *per se* is no substitute for sound professional judgment, but taking advantage of technology may facilitate effective IA. Thus, exploiting technology is revealed as another statistically validated indicator of the effective IAF.

6.1.8 Risk-based IA is applied to determine priorities of the IA activity (RBIA, Q21)

Of IAFs in Germany, only 54 percent of those in QU1 claim to be using a risk-based approach to determine the priorities for IA activity, while all of the IAF in QU4 claim to do so. The only six cases in the entire sample base in which risk-based IA is not applied are all in QU1. This observation suggests that the IAFs at the bottom end of the range should get the basics in place, which includes risk based IA (DIIR, 2007: 6).

6.1.9 Senior management provides input to the IA plan (SM_INPUT, Q24)

While all CAE in QU4 benefit from SM's input and suggestions to IA planning for audit subjects and *ad hoc* projects (Q24), only 46 percent of CAE in QU1 report the same. This result seems to confirm several academic studies that find that management support has a critical impact on IA effectiveness (e.g., Mihret and Yismaw, 2007; Halimah *et al.*, 2009; Cohen and Sayag 2010).

6.1.10 Board/AC provides input to the IA plan (AC_INPUT, Q25)

The board/AC provides no input to IA planning in the IAFs in QU1, whilst 71 percent of those in QU4 report that such input is provided. Given the specifics of the German

Corporate Governance Code (2010) and context and that SM is generally regarded as the chief stakeholder of IA, a relatively low score here should not be a complete surprise. Thus, it is striking that, despite the particular German context, the large majority of IAFs grouped at the top end of IA effectiveness benefit from the board's/AC's input to IA planning by suggesting audit subjects and *ad hoc* projects. This observation and the distinct spread between QU1 and QU4 support Chambers' (2008) suggestion that the board is the ultimate customer of IA and the acknowledgement that there are other governance stakeholders. However, direct access of the CAE to the board/AC mitigates the risk that the IA reports to the board may be filtered in such a way that only what is palatable to SM is communicated.

6.1.11 IA makes recommendations for improving the governance process (IA_GOV, Q26)

In this study, all CAEs grouped in QU4 claim to make recommendations to improve the governance process; that only applies to 54 percent of cases clustered in QU1. The discrepancy between what the IA definition claims IAF should do and what is done in practice is distinct. This study indicates that some groups of IAFs which may have more common features render an IA service that also includes improvements of the governance process, while most others do not.

6.1.12 IA rates individual findings and grades the overall report (GRADE, Q29)

All IAFs grouped in QU4 rate individual findings and grade the overall IA report, and that seems indicative of the rather effective IAF (Q29). Only 54 percent of IAFs at the lower end of the range of our sample apply that practice. Practice Standard 2410 (Criteria for Communicating) generally suggests that internal auditors' opinions and/or conclusions should be expressed (IIARF, 2011: 37). When communicating the results of IA work, IA reports that rate the individual findings (for example, high or medium issue) and grade the overall report (for example, satisfactory, marginally deficient or deficient) may help ensuring that IA reports are concise and clear and may be indicative of a comparatively higher level of IA effectiveness.

6.1.13 CAE has appropriate access to the board/AC (IA-AC_1, Q35)

It is remarkable that all cases in QU4 claim to have appropriate access to the board/AC, a feature that applies to only 38 percent of the cases in QU1. The statistical significance of

the board's/AC's input to the IA plan and the CAE's appropriate access to that oversight body may also be important for the DIIR who seek to enhance the gravitas of IA in Germany. Strategically positioning the IAF closer to the supervisory board to help the IAF's performance and effectiveness, may be worthy of consideration. The DIIR may consider, for example, practice advisories that suggest a stronger link between the CAE and the board/AC taking account of the 8th EU directive (EU, 2006).

6.1.14 CAE is contacted informally by SM, min. 3-4 times p.a. (IA-SM_3, Q40)

Seventy-one percent of CAE in QU4 are contacted informally at least three times per year by SM requesting ad hoc missions while only 15 percent of CAEs in QU1 report the same. The rapport between the CAE and SM has statistically valid discriminatory power, which confirms the many academic studies that support the critical impact that management support has on IA effectiveness.

6.2 Discussion of overall firm characteristics

The results related to demographics are consistent with expectations. A comparison of the population of cases grouped into QU1 with those in QU4 shows that the companies in QU4 typically have more employees and are larger in terms of revenue. We observe that IAFs that are more effective are significantly more common in larger companies. Thus, firm size is positively associated with an effective IAF. When performing the Fisher's exact Test that is recommended when cell values are small (Brosius, 2011: 429; Janssen and Laatz, 2010: 274) statistical significance can be confirmed regarding number of employees and revenues.

Table 2: Statistics of demographics confirm firm size impact

STATISTICS	OVERALL FIRM CHARACTERISTICS		
	Firm size 1. Employees	Firm size 2. Revenue	Industry 3. Sector
Fisher's exact Test	,043	,055	,194
Cramers V	,446	,498	N/A

The sample size does not enable any statistically based inferences to be determined in terms of industry impact. There are organizations in all quartiles from health care, life science, pharmaceuticals, manufacturing and engineering, and other businesses. In addition, QU1 includes one case from the food and beverages sector, and QU4 includes

three cases from the telecommunications industry.

7. Limitations

The questionnaire and its associated study have several limitations that should be kept in mind when interpreting the results.

Based on the underlying assumption that the IAF universe consists of IAFs with different levels of effectiveness, this study tests whether the IAF characteristics suggested in the literature can differentiate between groups of IAFs. This study distinguishes two groups at the lower and upper end of the range based on statistically validated IAF characteristics which may be associated with IA effectiveness, however future, formal research is needed to test this relationship.

All survey participants were members of the DIIR in Germany and members of its working groups in Germany, which (from a representative perspective) may distort the data in terms of its overall generalisability. The sample base may have over-sampled relatively strong cases of IAFs, as CAEs who believe they are managing a relatively effective IAF may have been more inclined to participate in the questionnaire than those that believe they are managing a relatively ineffective IAF.

There can be a disconnect between the 'supply-side perspective', which is based on the self-assessments of CAEs, and the 'demand-side perspective', which contains the stakeholder's expectations and perceptions (IIARF, 2011c). Self-perception and external perception may differ greatly (Ernst & Young, 2006: 29). The questionnaire as designed does not include the 'demand side perspective'. The replies are based on self-assessments by the CAEs, so the data is impacted and may be skewed by the potential self-bias that self-assessment may entail. We have no information on any self-reporting bias difference across the quartiles.

The relevance of the survey results is not limited to corporate governance regimes that have two-tier board structures. First because IA is (shall be) a pillar of corporate governance that is possibly not fully exploited within any corporate governance context. The study by Ernst & Young (2012: 1) shows that 80 percent of IAFs have room for improvement. In addition, and perhaps more importantly, regardless of whether there is a one- or two-tier board structure, the board/AC has an interest in benefitting from an

effective IAF.

8. Summary, conclusion, and suggestions for further research

The questionnaire has significant discriminating power in distinguishing the top and bottom end of the range. All building blocks of the implied IA effectiveness model point out statistically valid indicators and differences between IAFs clustered at both ends of the continuum. We suggest considering the discriminatory characteristics as meaningful criteria that may help to differentiate the comparatively effective from the comparatively ineffective IAFs. Thus, the RQ is favorably answered: the set of characteristics suggested by practitioners and academic literature, and complemented by our own considerations, provides statistically validated pointers that help to sort the wheat from the chaff.

8.1 Summary

This empirical survey provides a set of statistically validated characteristics with discriminatory power that separate two groups of IAFs. We argue that these characteristics can help to sort the wheat from the chaff as they may be associated with different levels of IA effectiveness at both ends of the range, separating comparatively strong and effective IAFs from comparatively weak and ineffective IAFs. While further formal research is needed to test this relationship, this study provides a tool by which to determine the level of IA effectiveness based solely on survey data. In doing so, this study plants the seeds of a theory that may enhance the understanding of IA effectiveness.

No one master question or indicator identified here separates the wheat from the chaff. The study confirms that input, process, output, organizational and relational factors influence IA effectiveness. IA effectiveness is viewed as a multi-faceted concept. All four building blocks of our reference model matter: organizational factors, IA resources, IA processes, and the pattern of relationships between the CAE and other key governance stakeholders.

8.2 Conclusion

We cluster key findings into micro-level and macro-level findings.

8.2.1 Micro-level findings

This study provides pointers that may help CAEs who want to sharpen IA effectiveness. The micro-level that may help the CAE improve the effectiveness of the IAF are: getting the basics in place (which requires having an IA charter, applying risk-based IA and writing IA reports that include ratings of individual findings and/or that grade the overall report), benefitting from co-sourced services to complement the IAF's skill set, giving adequate attention to qualification and continuous learning of IA staff, leveraging technology, and benefitting from appropriate interaction with SM and the board/AC.

Get the basics in place (including IA charter and risk-based IA)

The study shows that some IAFs need to ensure that the basics of IA are in place. While all IAFs at the top end report have an IA charter that clearly defines the role and mandate of IA in the organization, only about half of those at the bottom end do. In addition, risk-based IA, which is regarded a fundamental feature of effective IA, is not applied in half of IAFs at the bottom end. If CAEs want to enhance the effectiveness of the IAF, this is the area in which to start.

Rate individual findings and/or grade the overall IA report

All IAFs grouped in QU4 rate individual findings and grade the overall IA report; only 54 percent of IAFs in QU1 do so. We see a danger that IA reports are on auditors' action rather than on what is important to SM and/or the board/AC, and for the implications of risk and control (and governance, where applicable). If CAEs do not provide reports that matter to SM and/or the board/AC, and if CAEs cannot make their points effectively, SM and/or the board/AC may not pay much attention to what IA has to say, particularly when they are under time pressure. Rating individual findings and grading the overall IA report can be helpful in qualifying the findings and putting the report in a context that the addressee can easily understand and act upon as deemed necessary.

Benefit from co-sourced services to complement the IAF's skill

While all cases in QU4 benefit from co-sourcing, 46 percent of cases in QU1 do not, nor do they spend any money on professional service providers. We see CAEs knowing their own limitations as a positive. We draw attention to the type of *"know it all"* internal

auditor. Internal audits may easily become superficial, major issues can easily be missed, and the IAFs focus may be limited which may make it impossible for the CAE to render risk based IA services.

Aim to improve through qualification and continuous learning

This study shows that the level of training and continued learning emerges as a differentiating characteristic of IAFs. The study indicates that many, more effective IAFs require IA staff to have or to be working towards an IA qualification, whereas, only a fraction of the arguably less effective IAFs place such a demand on their staff. If the CAE wants to improve the effectiveness of the IAF, adequate attention should be given to training. It may sound trivial that training is important, however, in practice that may separate the wheat from the chaff.

Exploit technology.

This dissertation shows that some IAFs benefit from audit analytics like computer assisted auditing techniques (CAAT), while others do not. The evidence of this study may indicate that the more effective IAFs tend to benefit more fully from exploiting technology. The right use of technology can be an enabler of IA effectiveness. Audit technology may, for example, facilitate follow-up, strengthen risk based IA planning, and allow continuous risk assessment by identifying indicators (red flags) of potential fraud when screening business transactions as they occur.

Have the right level of informal communication with SM.

This survey confirms the importance of informal communication between the CAE and SM. The study shows that, while most CAEs in QU4 are contacted by SM informally, for *ad hoc* missions at least three times per year, only 15 percent of CAEs in QU1 are. CAEs who have only infrequent access to the SM in an informal setting may consider investing in that relationship. However, seeking a healthy balance is also important: while too little interaction seems to be a shortcoming, too much interaction can be harmful as well, because too many *ad hoc* missions can suggest that the IAF does not have adequate risk-based IA planning in place and that the CAE is not knowledgeable about what really matters for the organization.

Improve (and benefit from) the level of access to the board/AC.

If the CAE wants to improve the effectiveness of the IAF and to have an active role in corporate governance, the study points to the importance of input from the board/AC to the audit plan. The result of this study should encourage CAEs to embrace any opportunity to present their work directly to that oversight body and heighten the chances of obtaining (earning) that access.

8.2.2 Macro-level findings

The macro-level findings and implications of the study address the IIA/DIIR, rather than the CAE.

Upgrade the value of IA designations for CAEs.

While no CAE in QU1 holds a professional IA qualification, only 43 percent of CAEs in QU4 are qualified internal auditors. This finding poses questions about the value of the educational content in the IA qualification process and the perceived value and benefit of IA qualifications for the most senior audience in the IA profession, the CAEs. The IIA/DIIR may consider reviewing the curricula and seeking ways to increase the value of IIA designations for CAEs.

Strengthen quality assurance and improvement programs.

As compliance with the professional Attribute Standard 1300 (Quality Assurance and Improvement Program) is unsatisfactory, the study is particularly relevant for the IIA/DIIR, as well as for CAEs and other professionals who are engaged in quality assurance and improvement programs. Whether they are performed internally or externally, such review programs may be strengthened by focusing on more pointed questions. With an improved value proposition, acceptance by internal auditors themselves may also increase and compliance with the professional Attribute Standard 1300 may be heightened in a way that will improve the overall quality of IA service rendered.

Emphasize the link between the CAE and the oversight body.

The study shows that the link between the board/AC's input to the IA plan and the CAE's

appropriate access to that oversight body is statistically significant: all cases in QU4 report having appropriate access to the board/AC, but only about a third of the cases in QU1 do. This finding is important for the IIA/DIIR who seeks to increase the influence of IA in Germany. For example, the IIA/DIIR may consider practice advisories that position the CAE closer to the board/AC. In doing so, the potential for unexpected and adverse implications when the CAE reports directly to the AC must be considered (Norman *et al.*, 2010).

8.3 Suggestions for further research

This study plants the seeds of a theory that may stimulate further studies on the topic of IA effectiveness.

Understand why some IAFs have no charter.

Further study of why some IAFs do not have such an IA charter would be useful, especially as it is a basic requirement that members of the IIA/DIIR are expected to have in place.

Understand why some IAFs do not benefit at all from co-sourcing activities.

If benefitting from some degree of co-sourcing is in principle viewed as helpful in improving the IA value proposition, we suggest further research as to why some IAFs ignore that opportunity.

Clarify the pros and cons of rating individual findings and grading the overall IA report.

As brevity and clarity of IA reports typically matter to SM and the board/AC, we suggest further study into why some IAFs avoid rating the findings and grading the overall report.

Clarify the pros and cons of anyone being able to sign an IA report.

The IIA may consider emphasizing the certification of membership, which includes the possibility of only allowing qualified members to sign and issue an IA report.

Learn more about the career paths and characteristics of the effective internal auditor.

Future research should seek to clarify the career pattern of internal auditors and on what basis they make career choices to move into and out of the IA profession. In that context, further research should explore the possibility of an optimum life cycle for performing IA most effectively. Such studies may provide insights and explanations as to why external audit is characterized by clear career paths, whereas IA is often viewed as a stepping-stone to something else (O'Regan, 2001).

Examine the relational dimension of IA.

The CAE's interaction with other governance stakeholders emerges as an important topic. Future research should examine that relational dimension of IA effectiveness and the CAEs' interactions with other governance stakeholders.

Study the conditions when reliance by external audit on IA is a helpful indicator of IA effectiveness, and whether and when it may be misleading.

In this survey, we could not find pointers, which indicate that IA effectiveness may be inversely related to external audit's reliance on IA. Whereas external auditors do not rely on work that is performed by the IAFs in QU4, they do in 23 percent of the cases in QU1. While statistical significance was not reached in this area, researching the reliance question (or, rather, the 'anti-reliance assumption' as postulated in this paper) of external audit on the work performed by IA could provide more definitive evidence of its being – or not being - an indicator of IA effectiveness.

Study the relationship of the use of technology and the effectiveness of IA

The use of technology like CAAT has been largely under-explored in academic research on IA effectiveness. This study may encourage other scholars to fill that void.

Test and strengthen the discriminatory power of indicators.

Future research may challenge and build on the findings of this research by testing the relationship of the questions that separate IAFs and their relationship with IA effectiveness in a German setting and elsewhere.

Study the impact of the overall corporate governance context on IA effectiveness

The existence of a comparatively weak corporate governance context may be an important

limitation for the IAF's ability to be fully effective.

Develop a theory to test and explain the determinants of IA effectiveness.

As *'nothing is quite so practical as a good theory'* (Lewin, K., 1945; cited in Van de Ven, 1989: 486), this study may be a stepping stone in theory development and testing and in further advancing understanding of the factors associated with IA effectiveness. Not only deepening the understanding of the factors for IA effectiveness – that is, the building blocks, but also further study of the cement mortar that helps hold the blocks together could answer questions not addressed in this study. There is much yet to be discovered.

This survey suggests an IA effectiveness mosaic that may heighten the chances of recognizing an effective IAF if we come across one. However, based on this study, we can only assume that the differentiating characteristics in our theoretical model are associated with IA effectiveness. Further studies are needed to validate the findings of this research and to test any differences between various groups as far as effectiveness is concerned. To test this relationship more formal, qualitative and possibly experimental research may be helpful to provide insights into the relative causalities of the factors that influence IA effectiveness.

Appendix

Appendix A: Snapshot questionnaire, German version translated into English

Internal audit effectiveness

1) What is your industry sector (choose one from this list):

- ❍ Banks and building societies
- ❍ Insurance
- ❍ Other financial services
- ❍ Food and drink
- ❍ Manufacturing and engineering
- ❍ Media and leisure
- ❍ Retail
- ❍ Telecommunications
- ❍ Utilities
- ❍ High technology
- ❍ Health care, life science, pharmaceuticals
- ❍ Other private sector
- ❍ Voluntary/charity
- ❍ Education
- ❍ Central government
- ❍ Local government
- ❍ Health
- ❍ Other public sector
- ❍ Other (please specify)

If you selected other, please specify

_____

2) What is the total number of employees in your organisation? (If your organisation is international or has multiple divisions, your answer should cover only that part of the organization, which your internal audit services cover)

- ❍ less than 100
- ❍ 101 to 500
- ❍ 501 to 1,000
- ❍ 1,001 to 5,000
- ❍ 5,001 to 10,000
- ❍ 10,001 to 25,000
- ❍ 25,001 to 50,000
- ❍ over 50,000

3) What is the turnover or net revenue spend of your organisation? (Provide the worldwide total for multi-national organisations)

- ❍ Up to €12 million
- ❍ €13m - 30m
- ❍ €31m - 60m
- ❍ €61m - 240m
- ❍ €241m - 600m
- ❍ €601m - 1.2bn
- ❍ €1.2bn - 6bn
- ❍ €6bn - 12bn
- ❍ Over €12bn

INTERNAL AUDIT ROLE and MANDATE

4) How do you rate Corporate Governance in your organisation (think of ethical values, risk and control awareness, respect to risk management and internal control, tone from the top etc.).

- ❍ very strong
- ❍ strong
- ❍ neutral
- ❍ weak
- ❍ very weak
- ❍ Other (please specify)

If you selected other, please specify

_____

5) The organisation has an internal audit function because it is a legal requirement.

- ❍ yes
- ❍ no
- ❍ don't know

6) How has the internal audit budget changed in the past 2 years?

- ❍ lower funding
- ❍ no change
- ❍ higher funding

7) How is the internal audit budget expected to change in the next two years?

- ❍ lower funding
- ❍ no change
- ❍ higher funding

8) Does your internal audit activity have an Internal Audit Charter that has been agreed by the board (audit committee)?

- ❍ yes
- ❍ no
- ❍ don't know
- ❍ Other (please specify)

If you selected other, please specify

_____

INTERNAL AUDIT RESOURCES

9) How long do internal audit staff stay on average in the function?

- ❍ 0 - 2 years
- ❍ 3 - 4 years
- ❍ 5 - 7 years
- ❍ more than 7 years

❍ Other (please specify)

If you selected other, please specify

_____

10) When internal audit staff leave the internal audit function but continue to work for the organisation what is generally the next step?

❍ demotion
❍ lateral move
❍ promotion
❍ Other (please specify)

If you selected other, please specify

_____

11) What is the combined percentage of co-sourced and outsourced internal audit activity?

❍ none
❍ 1 - 10%
❍ 11 - 20%
❍ 21 - 30%
❍ 31 - 40%
❍ 41 - 50%
❍ more than 50%

12) On average, how many hours training does each internal auditor receive during the year?

❍ less than 40 hours per year
❍ 40 hours per year or more

13) Have internal auditors been given adequate professional training to perform governance, fraud and ethical audits?

	yes	no
governance audits	❍	❍
fraud audits	❍	❍
ethical audits	❍	❍

14) How long have you been in your current role?

❍ less than one year
❍ less than two years
❍ less than three years
❍ less than four years
❍ less than five years
❍ less than six years
❍ less than seven years
❍ more than seven years

15) Have you worked in a senior position outside of internal audit?

❍ yes
❍ no

16) Do you have a professional internal auditing qualification, for example PIIA, MIIA, QiCa, and CIA?

❍ Yes
❍ No

17) Are internal audit staff required to have a professional internal auditing qualification, for example PIIA, MIIA, QiCa, CIA?

❍ yes
❍ no

18) Do you regularly participate in networking and social events with internal auditing peers from other organisations?

	yes	no
internal auditing seminars and conferences	❑	❑
round table discussions about internal auditing	❑	❑
internal auditing workshops	❑	❑
IIA working groups	❑	❑
IIA regional groups	❑	❑

INTERNAL AUDIT PROCESS

19) Does the internal audit function use Computer Assisted Auditing Techniques (CAAT)?

❍ yes
❍ no

20) Has the internal audit function been subject to an external quality assessment in the past five years?

❍ yes
❍ no
❍ Other (please specify)

If you selected other, please specify
_____

21) Are you using a risk-based approach to determine the priorities of the internal audit activity?

❍ yes
❍ no
❍ Other (please specify)

If you selected other, please specify

_____

22) Does your organization use assurance mapping to identify who provides assurance for key risks?

- ❍ yes
- ❍ no
- ❍ Other (please specify)

If you selected other, please specify

_____

23) Do you assess the reliability of assurance services from other parts of the organization?

- ❍ yes
- ❍ no
- ❍ Other (please specify)

If you selected other, please specify

_____

24) Does senior management provide input to internal audit planning by suggesting audit subjects and ad hoc projects?

- ❍ yes
- ❍ no
- ❍ Other (please specify)

If you selected other, please specify

_____

25) Does the board/audit committee provide input to internal audit planning by suggesting audit subjects and ad hoc projects?

- ❍ yes
- ❍ no
- ❍ Other (please specify)

If you selected other, please specify

_____

26) Does the internal audit activity assess and make recommendations for improving the governance process?

- ❍ yes
- ❍ no
- ❍ Other (please specify)

If you selected other, please specify

_____

27) Does the internal audit activity evaluate the effectiveness of risk management processes?

- ❍ yes
- ❍ no
- ❍ Other (please specify)

If you selected other, please specify

_____

28) When, on average, are *final* internal audit reports issued after completion of the audit?

- ❍ within one week of completion
- ❍ within two weeks of completion
- ❍ within three weeks of completion
- ❍ after three weeks of completion

29) Do you rate or grade the findings in your audit reports and/or give an overall rating to your reports?

	yes	no	don't know
individual findings	❍	❍	❍
overall report	❍	❍	❍

30) How often do you follow-up progress of your recommendations?

- ❍ annually
- ❍ twice a year
- ❍ three times a year
- ❍ four times a year
- ❍ more than four times a year
- ❍ Other (please specify)

If you selected other, please specify

_____

31) On the whole what percentage of recommendations of an internal audit are implemented timely and effectively?

- ❍ less than 50%
- ❍ 50% to < 60%
- ❍ 60% to < 70%
- ❍ 70% to < 80%
- ❍ 80% to < 90%
- ❍ 90 - 100%

32) What measures of effectiveness do you use (choose all that apply)?

- ❑ number of recommendations accepted
- ❑ number of recommendations implemented
- ❑ improvements and cost savings from recommendations

- ❑ customer surveys from auditees
- ❑ number of management requests for ad-hoc audits and projects
- ❑ reliance by external audit on internal audit
- ❑ no formal measurement
- ❑ Other (please specify)

If you selected other, please specify

_____

INTERNAL AUDIT RELATIONSHIPS

33)
To whom does internal audit report to functionally?

- ❍ board (Chairman or member)
- ❍ audit committee (Chairman or member)
- ❍ executive Management (either CEO, Deputy CEO or CFO or so)
- ❍ Other (please specify)

If you selected other, please specify

_____

34)
To whom does internal audit report administratively?

- ❍ Chief executive or Deputy CEO
- ❍ Chief financial officer
- ❍ company secretary
- ❍ chief risk officer
- ❍ chief compliance officer
- ❍ Other (please specify)

If you selected other, please specify

_____

35) Do you believe that you have appropriate access to the board / audit committee?

- ❍ yes
- ❍ no
- ❍ Other (please specify)

If you selected other, please specify

_____

36) How often do you meet *formally* with the board (audit committee)?

- ❍ monthly
- ❍ quarterly
- ❍ annually
- ❍ never
- ❍ Other (please specify)

If you selected other, please specify

_____

37) How often are you contacted *informally* (outside formal audit committee meetings) by the head of the audit committee or other audit committee members?

- ❍ never
- ❍ 1-2 times per year
- ❍ 3-4 times per year
- ❍ more than 4 times per year
- ❍ Other (please specify)

If you selected other, please specify

_____

38) Do you believe that you have appropriate access to senior management?

- ❍ yes
- ❍ no
- ❍ Other (please specify)

If you selected other, please specify

_____

39) How often do you report *formally* to senior management?

- ❍ weekly
- ❍ monthly
- ❍ quarterly
- ❍ bi-annually
- ❍ annually
- ❍ never
- ❍ Other (please specify)

If you selected other, please specify

_____

40) How often is senior management contacting you *informally*, and requesting ad hoc missions to be carried out?

- ❍ never
- ❍ 1-2 times per year
- ❍ 3-4 times per year
- ❍ more than 4 times per year
- ❍ Other (please specify)

If you selected other, please specify

_____

41)
Do external auditors rely on the work performed by the internal audit function?

- ❍ yes, in full
- ❍ yes, partly
- ❍ no
- ❍ don't know
- ❍ Other (please specify)

If you selected other, please specify

_____

42) If you would like to receive the academic papers and take further part in this research project please leave your email address below:

_____
_____
_____

Data Protection Notice

Thank you for completing the survey, your views and opinions are very important.

Your response will be treated in total confidence.

Completed questionnaires will be processed only by the Institute of Internal Auditors - UK and Ireland (IIA) using Vovici EFM Continuum software and will not be disclosed to any other third parties. By submitting this questionnaire you consent to our processing of your sensitive personal data for these purposes.

Appendix B: Scoring model

	Q#	Code	Issue underlying question	Score = 1	Score = 0
Org-anization	4	GOV	Overall Corporate Governance context	very strong or strong	neutral, weak or very weak
	5	LEGAL	Having an IAF is a legal requirement	Yes	No
	6	B-2	IAF budget in the past two years	No change or higher funding	Lower funding
	7	B+2	IAF budget expected in the two coming years	No change or higher funding	Lower funding
	8	IA_C	IA charter exists and is agreed by the board/AC	Yes	No
IA resources	9	TEN_IA	Tenure of IA staff on average in IAF	3-7 years	0-2 years, more than 7 years
	10	NEXT	Next move of IA staff is generally a ...	Lateral move or promotion	Demotion
	11	CO_S	Combined share of co-sourcing and outsourcing of IA services is 1-40%	1-40%	None or more than 40%
	12	TRA_IA	Training of IA staff	40 hours per year or more	Less than 40 hours per year
	13	TRA_GFE	Training of IA staff provided for governance, fraud and ethical audits	min. 2 out of 3	1 or none
	14	TEN_CAE	Tenure of CAE in current role	3-7 years	0-2 years, more than 7 years
	15	SEN	CAE has worked in Senior position outside IA	Yes	No
	16	Q_CAE	CAE has a professional IA qualification	Yes	No
	17	Q_IA	IA staff are required to have a professional IA qualification	Yes	No
	18	NET	CAE participates in networking activities with IA peers	2 or more activities	1 or none
IA processes	19	CAAT	IAF uses CAAT (Computer Assisted Auditing Techniques)	Yes	No
	20	EA-5	External quality assessment was performed in the past five years	Yes	No
	21	RBIA	Risk-based IA is applied to determine priorities of the IA activity	Yes	No
	22	AMAP_1	Assurance mapping is used to identify assurance providers for key risks	Yes	No
	23	AMAP_2	Assessment of the reliability of assurance provided by others	Yes	No
	24	SM_INPUT	Senior management provides input to the IA plan	Yes	No
	25	AC_INPUT	Board / Audit committee provides input to the IA plan	Yes	No
	26	IA_GOV	IA makes recommendations for improving the governance process	Yes	No
	27	IA_RM	IA evaluates the effectiveness of risk management processes	Yes	No
	28	TIME	Final IA reports are published after completion of the audit	Within two weeks of completion	Within or after three weeks of completion
	29	GRADE	IA rates individual findings and grades the overall report	Yes	No
	30	FOLLOW	IA follows-up on status of issues min. three times per year	Min. three times per year	Less than three times per year
	31	DONE	Percentage of IA findings implemented timely	90-100%	Less than 90%
	32	MEASURE	Used measures of effectiveness	Min. three and "reliance by external audit" does not apply	Less than three or/and "reliance by external audit" does apply
IA relation-ships	33	REP_F	Functional reporting line to board or audit committee	Yes	No
	34	REP_A	Administrative reporting line	Reporting line to either CEO/Deputy/CFO/Company secretary	Reporting line another function
	35	IA-AC_1	Appropriate access to board/audit committee	Yes	No
	36	IA-AC_2	CAE meets *formally* with the board (audit committee)	Monthly or quarterly	Less frequent
	37	IA-AC_3	CAE is contacted *informally* by audit committee	Min. 3-4 times per year	Less frequent
	38	IA-SM_1	CAE has appropriate access to Senior management	Yes	No
	39	IA-SM_2	CAE reports *formally* to Senior management weekly	Monthly or quarterly	Less frequent
	40	IA-SM_3	CAE is contacted *informally* by Senior management	Min. 3-4 times per year	Less frequent
	41	EA_IA	External auditors rely on the work performed by IAF	No	Yes

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PAPER 5

INTERNAL AUDIT EFFECTIVENESS:
MULTIPLE CASE STUDY RESEARCH IN GERMANY APPLYING ROLE THEORY AND THE RELATIONAL THEORY OF COORDINATION

Abstract

Purpose - This research augments the understanding of Internal Audit (IA) effectiveness by studying organizational, personal, and particularly interpersonal factors brought into focus by the lenses of Role Theory (Kahn *et al.* 1964), supplemented by the Theory of Relational Coordination (Gittell 2006). Within the specific German Corporate Governance context, where Senior Management (SM) is generally regarded as the 'chief stakeholder' of IA, the study reveals differences between more or less effective IA functions (IAFs) and addresses the 'why' type questions that arise there from.

Design/methodology/approach – Subsequent to preceding literature research, sixteen semi-structured interviews of heads of Internal Audit (CAE) and members of SM in the same organization were conducted.

Findings – Since in practice expectations can vary significantly and as sometimes very little may be demanded, this study highlights the danger of viewing customer satisfaction as the key measure of IA effectiveness, because it can easily be misleading. Interpersonal factors can enhance or detract from IA effectiveness. CAEs who interact frequently and in a timely manner with SM using problem-solving communication nurture IA effectiveness, especially when such communication is supported by shared goals, shared knowledge, and mutual respect. Organizational factors play an important role, evidenced by the 'hidden champions', organizations that demand and benefit from effective IA practices. Personality factors also affect IA effectiveness. 'Swimming in the organization' and 'Fingerspitzengefühl' are suggested metaphors for effective internal auditors while on the other hand in practice, IA designations for CAEs were not found to be of added value.

Practical implications - Practitioners will benefit when transferring the insights of this paper into their respective contexts by reflecting on the enhancing and detracting dimensions of IA effectiveness that are framed by the dynamics of organizational, personal and interpersonal factors.

Originality/value - This paper breaks new ground in applying Role Theory (Kahn *et al.*,

1964) in combination with the Theory of Relational Coordination (Gittell 2006) to the research context of IA effectiveness. This study is one of very few studies on IA effectiveness where interviews were conducted with both the CAE and SM in the same organization, and it is the first study of that type in the German context.

Keywords - Internal auditing, effectiveness, role theory, theory of relational coordination

Paper type – Empirical paper

Introduction and context

This study provides insights into the effectiveness of Internal Audit (IA), a subject matter that is a sort of "Elephant in the room", an obvious issue no one or only a few want/s to discuss for IA effectiveness has been largely unaddressed in academic research.

The effectiveness of IA is associated with Corporate Governance. The beginning of the twenty-first century has seen large corporate bankruptcies, such as that of Lehmann Brothers as a prominent and recent example (Valukas 2010). Bailouts of entire countries have also occurred, jeopardizing even whole continents. It has been suggested and is now planned that going forward the European heads of state meet regularly in order to strengthen governance in the Euro Zone (NZZ 2011) since a major corporate collapse in one country can have *"knock-on effects around the globe, the fallout rippling like waves in a pool"* (Mallin 2007, 267). Thus, while the nineteenth century can be regarded as the century of entrepreneurs, and the twentieth century became the century of management, the new century promises to become the era of corporate governance (Tricker 2000, 289; Baker and Anderson 2010, 3). Despite the explosion of interest in the matter, in theory and in practice, there is no full explanation yet for the complex and changing phenomena of corporate governance (Clarke 2007, 20). Consequently, it is not surprising that there is no universally accepted definition of corporate governance (Cohen *et al.* 2010, 757). The UK Corporate Governance Code (FRC 2012, 1), for example, defines the purpose of corporate governance as that of "[facilitating] effective, entrepreneurial and prudent management that can deliver the long-term success of the company."

Notably, the Institute of Internal Auditors (IIA), the globally recognized standard-setter of IA practices, regards IA as a pillar of corporate governance. While aspiring to universal recognition as a profession, IIA acknowledges that some stakeholders in the governance arena challenge that claim and view IA critically (e.g., Anderson 2009, Chambers 2008, and Deloitte 2010), as IA has not been seen to be part of the problem or part of the solution in the financial crisis that started in 2007. Therefore, there is some tension between the perceived value of IA between IA and some of its customers (Lenz and Sarens 2012).

It is clear that the subjects of corporate governance and IA effectiveness are highly topical in practice and are gaining academic attention. IA is effective when it accomplishes its

purpose and ensures *"the achievement of a desired condition"* (Dittenhofer 2001, 445), i.e., inspired by ISSAI 3000 (2004, 17), we regard IA effectiveness as a "risk based goal-attainment concept that helps organizations to achieve their objectives".[1] This multiple-case-study research seeks to enhance the understanding of IA effectiveness while considering the perspectives of the head of Internal Audit (Chief Audit Executive, CAE) and Senior Management (SM) in the same company.

The central subject of this research is the relationship between the CAE and SM and its impact on IA effectiveness. Support from SM is viewed as a critical enabler for IA effectiveness (Cohen and Sayag 2010, Halimah *et al.* 2009, Mihret and Yismaw 2007, Sarens and De Beelde 2006a, 2006b). Studying that relationship is particularly suitable for this research, as the sample firms that are examined are all headquartered in Germany. As such they are subject to the German Corporate Governance Code (2010) in which context, although SM is generally regarded as the chief stakeholder of IA, IA may or may not have direct access to the supervisory body ("Aufsichtsrat" or "Beirat") or a sub-committee thereof, such as the audit committee (Egner 2011, 39; Günther and Gonschorek 2008, 139; Hölscher and Rosenthal 2011, 489; also Velte 2011, 575). This approach renders this study unique, as prior research on IA effectiveness in Germany has been largely conceptual (Hölscher and Rosenthal 2011) or based on self-assessments by CAEs only (Geis 2010). It is one of very few studies on IA effectiveness where interviews are conducted with both the CAE and SM in the same organization. This complements Sarens and De Beelde (2006b) and Soh and Martinov-Bennie (2011) who study this relationship in a Belgian and Australian setting, respectively, and it is the first study in the German context where CAEs and SM in the same organization are interviewed.

The overarching German corporate governance context is characterized by a two-tier board structure (Appendix A), with a management board and a separate supervisory board (German Corporate Governance Code 2010). The two boards are distinct, in terms of both membership and responsibilities. The management board is responsible for managing the company, while the supervisory board advises and supervises the management board's activities and is responsible for appointing and removing members of the management board and setting up an audit committee to handle and oversee issues of accounting, risk management, and compliance. The German Corporate Governance Code (2010) and the

[1] ISSAI 3000 (2004), issued by the International Organization of Supreme Audit Institutions, presents standards and guidelines for performance auditing in the public sector.

German Accounting Law Modernization Act (BilMoG 2009) are particularly important in acknowledging that it is common practice in Germany for the CAE to report directly to the management board[2] ("Vorstand" or "Geschäftsführung" depending on the type of legal entity). Consequently, in Germany SM is generally regarded as the chief stakeholder of IA, which reduces potential uncertainty and ambiguity that could result when IA serves two masters (Anderson 2003, Beasley *et al.* 2009, Chambers 2008, Deloitte 2010, Hermanson and Rittenberg 2003, IIARF 2003, Lenz and Sarens 2012). Therefore, this potential impact is less of a concern or limitation in this study than in some others, but *"the internal auditor's role is an enigmatic one"* that is characterized by *"role dilemma" and "role confusion",* e.g., when expected to be *"both watchdog and consultant"* (Van Peursem 2004, 379, and Van Peursem 2005, 491 and 510).

This paper is structured as follows:

Section 1 reviews major facets of the existing literature on IA effectiveness.

Section 2 depicts the theoretical framework of the study and presents the three research questions (RQ). We aim to better understand the features that distinguish the more effective IAFs from the less effective IAFs. In doing so, the paper applies a novel combination of theories that provides insights and represents a promising framework for studying the effectiveness of IA. We wish to break new ground with this paper.

Role theory (Kahn *et al.* 1964) is applied in combination with Gittell's (2006) theory of relational coordination. Organizational factors, personality factors, and interpersonal factors are the three building blocks of role theory (Kahn et al 1964, 30), which is a theoretical model of factors involved in adjusting to role conflict and ambiguity. In examinations of interpersonal factors, that is, the relationship and interplay between the CAE and SM in different organizations, the theory of relational coordination (Gittell 2006) complements role theory (Kahn et al 1964), as the theory of relational coordination offers additional explanatory power on a specific aspect of role theory.

Role theory (Kahn *et al.* 1964) explains the overall context of IA effectiveness, as all three of its factors are viewed as highly relevant in studying this subject matter. The

[2] According to a survey by the DIIR, the German Institute of Internal Auditors, 82 percent of CAEs in Germany report solid line to the CEO, to a member of the SM team, or to the entire SM team (Eulerich 2011, 22).

organizational impact is identified as an important dimension that influences IA effectiveness (Mihret et al 2010, 241), and such contextual factors merit further research in the study of IA effectiveness. Personality factors are also viewed as essential factors (Van Peursem 2005, Rittenberg and Anderson 2006), and some prior research, such as that of Cohen and Sayag (2010), regard interpersonal relationships, especially that between the CAE and SM, as arguably paramount.

The second theory that is applied, the theory of relational coordination (Gittell 2006), focuses on the interpersonal relationships dimension of role theory (Kahn *et al.* 1964), so it facilitates additional observations. We view Gittell's theory (2006) as particularly helpful in understanding and explaining the influence of 'soft factors' which we find fundamentally important for *"The essential is invisible to the eyes"* (de Saint-Exupéry 1943).

Section 3 describes the multiple-case-study research methodology that is applied. The CAE and SM from the same organization are interviewed: eight cases (A through H) are studied through sixteen interviews. This research seeks to study extreme cases, sort of *"maximum variation"* sampling (Miles and Huberman 1994, 28), that is, it identifies cases of comparatively strong and effective IAFs and cases of comparatively poor and ineffective IAFs. This research design was chosen as it is hypothesized that extreme cases may potentially illustrate differences more clearly (Glaeser and Laudel 2009, 99).

Section 4 presents the results of the study, which confirms the suitability and explanatory power of the theories that were jointly applied in researching the phenomena of IA effectiveness. Three key observations follow:

- Organizational factors influence IA effectiveness. *"Hidden champions"* (Simon 2009) seem to demand and benefit from effective IA practices.

- Personality factors also influence IA effectiveness. The metaphors *"swimming in the organization"* and *"Fingerspitzengefühl"* suggest that personal attributes are of paramount importance and key success factors for IA effectiveness.

- Interpersonal factors are critical in determining IA effectiveness as they provide explanatory power, arguably enabling the "wheat" to be sorted from the "chaff"; that is, they allow the comparatively strong and effective IAFs to be differentiated

from the comparatively weak and ineffective IAFs. At the high end, CAEs who interact frequently and in a timely manner with SM, in a problem-solving communicative style, nurture IA effectiveness, particularly when their communication is supported by relationships of shared goals, shared knowledge, and mutual respect. At the low end, when CAEs interact infrequently with SM, and the pattern of interaction is characterized by delayed and possibly finger-pointing communication, ineffective IAFs are likely to result. Clear expectations from SM are identified as important in helping the CAE to perform. At the same time, the study highlights the fact that meeting expectations from SM as a criterion when measuring IA effectiveness can easily be misleading, as expectations in practice vary widely, and may demand very little, as one case study makes especially clear (case C). It seems that organizations ultimately have the IAF they want, as the CAE and key stakeholders tend to have congruent expectations. That mechanism works both ways, thus possibly increasing or decreasing the chances that the IAF will be effective.

Section 5 points out limitations of the study, and section 6 summarizes key conclusions and suggests avenues for further research.

1. Literature review

The concept of IA effectiveness is prominently positioned in the IIA definition (IIARF 2011a, 2) and actively debated in practice (e.g., Deloitte 2010, Ernst & Young 2006 and 2008, KPMG 2009, PWC 2009, 2010). However, in academic research, IA effectiveness is a relatively unexplored area (Anderson 2003, Arena and Azzone 2009, Cohen and Sayag 2010, Hermanson and Rittenberg 2003, Paape 2008, Prawitt 2003, Sarens 2009 and Soh and Martinov-Bennie 2011).

According to Dittenhofer (2001, 450), effective IA helps organizations achieve their objectives, although Dittenhofer acknowledges the difficulty in determining appropriate measurement criteria to confirm effectiveness. When something is "effective" it is adequate to accomplish a purpose and to ensure *"the achievement of a desired condition"* (Dittenhofer 2001, 445). From that perspective, effectiveness is synonymous with the achievement of goals. The IA report is regarded as an output that cannot be effective *per se*, but that output may trigger intended change, and it is that intended change - that specific outcome and possibly lasting impact that accomplishes the desired improvement – that matters (Brombacher 2012, 395). Meeting customer expectations is a meaningful referent in measuring IA effectiveness as it has the conceptual merit of considering IA's customers (Mihret *et al.* 2010), and it is in line with Drucker (1985, 172), who may have been the first to observe, *"quality in a product or service is not what the supplier puts in. It is what the customer gets out and is willing to pay for".* However, in practice, as Soh and Martinov-Bennie (2011, 616 and 618) show, the most commonly employed measures of IA effectiveness still relate to its efficiency with regard to delivery of the annual IAF work plan and the acceptance and adoption of IA recommendations. Thus, relying on efficiency related criteria points to a misalignment between the IAF role and its evaluation, a misalignment that may be attributable to unresolved difficulties in assessing the extent to which the IAF is meeting stakeholders' expectations.

Whoever the main stakeholder may be in practice, the skills and competences of the individual internal auditor are important factors (Arena and Azzone 2009, Cahill 2006, Pforsich *et al.* 2006 and 2008, Prawitt 2003, Rittenberg and Anderson 2006, Van Peursem 2005). However, even the best set of qualities may be futile when they are not compatible with the politics and culture of an organization (Abdolmohammadi and Sarens 2011, Chanchani and MacGregor 1999, Sarens and Abdolmohammadi 2011). Such qualities

may also be futile when professional IA services are not wanted and are considered the *"Cinderella function by management"* (Davies 2009, 61). These two dimensions – the individual auditor as a group of people, the IAF, and applied IA processes, and the organizational context they are embedded in - are important factors that affect IA effectiveness. Consequently, they form the scope of this research, with relational aspects as its core theme.

The relationship between the CAE and SM is only one of many relationships. Soh and Martinov-Bennie (2011, 608) point out that the (perceived) quality of IA work may vary according to the viewer's perspective, especially as stakeholders can be numerous, and their expectations are not necessarily congruent. In addition to SM, the audit committee/board and external audit (EA) are frequently referred to as stakeholders.

When IA effectiveness is assessed from an EA perspective, the higher the utilitarian benefit is for EA, the higher the perceived IA quality is. Thus, the value that EA sees in IA is dominated by the reliance question (Cohen et al 2007, Desai and Desai 2010, Felix *et al.* 2001 and 2005, Gramling *et al.* 2004, Krishnamoorthy 2002).

Academia frequently refers to meeting the expectations of the audit committee and the main board as one important stakeholder (Arena and Azzone 2009, Chambers 2008, Davies 2009, Goodwin 2003, Goodwin and Yeo 2001, Norman *et al.* 2010, Raghunandan *et al.* 2001, Rezaee and Lander 1993, and Scarbrough *et al.* 1998). While Chambers (2008) suggests seeing the board as the most important stakeholder of the IAF, Norman *et al.* (2010) point to potential unexpected and adverse implications when the CAE reports directly to the board or the audit committee.

Support from SM is fundamental for IA effectiveness (Cohen and Sayag 2010, Halimah et al 2009, Mihret and Yismaw 2007, Sarens and De Beelde 2006a and 2006b) as is the SM's appreciation of IA as Geis (2010) found in a study of potential benefits of IA in Germany that used interviews with eight CAEs. The first part of Geis' study suggests a number of indicators for measuring effectiveness, including customer surveys of auditees, the number of IA findings, the time between the end of field work and delivery of the report, and the percent of findings being implemented (Geis 2010, 95). The study builds on the work by Parasuraman *et al.* (1985) based on the concept that the more the expectation gap is narrowed, the more effective IA may perform as customers of IA

measure the *perceived* benefit relative to the *expected* benefit (Geis 2010, 149).

The concept of "expectation matching" is further examined in applications of role theory (Kahn *et al.* 1964) supplemented by the theory of relational coordination (Gittell 2006) as the lenses, thereby taking the perspective of the service provider (the CAE leading the IAF) and the perspective of the main service recipient in Germany - that is SM – into account. Geis (2010, 125) points to the challenge that exists when customers of IA have only hazy expectations or no expectations at all, and to the threat to independence that the suggested customer focus may entail. Geis' study drew no conclusions about those expectations since customers were not included in the research design, that aspect of vague expectations is examined in the present field research.

To perform this examination, this research incorporates CAEs and SM, as the literature on IA effectiveness indicates is a significant disconnect between the "supply-side perspective" – that is, self-assessments by internal auditors - and the "demand-side perspective", - that is, the stakeholder's expectations and perceptions (IIARF 2011b). A stakeholder survey conducted by Ernst & Young (2006, 29) in Germany provides evidence of significant differences between the self-assessment of internal auditors and the perspective of other key stakeholders. For example, while 81 percent (100 percent in banks) of CAE self-assess their acceptance in the organization and professionalism as outstanding, their level of acceptance is seen in more muted terms by SM, only 55 percent of whom assess it as outstanding. Thus, self-perception and external perception can differ greatly. The Ernst & Young report (2006, 30) offers two explanations for this difference: the huge difference stems from hubris on behalf of internal auditors or it is attributable to a lack of understanding on the part of SM as to what services IA provides. In other words, "there is a lack of adequate communication". Research on that communication or the potential lack thereof is the subject of this research, which sets out to unveil differences between more or less effective IAFs and addresses questions of a "why" nature.

Before presenting the results of the multiple-case-study in section four and describing the methodology applied in section three, we present the theoretical lenses through which the data are examined.

2. Theoretical framework

As *"theory without data is empty and data without theory say nothing"* an appropriate

theoretical framework needs to be determined when data 'that answers questions of why' are analyzed and interpreted (Moisander and Valtonen 2006, 103 and 38).

Academic studies in the field of IA point to the particular importance of the relationship between CAE and SM (e.g., Cooper 1994, Coyen and Sayag 2010, and Norman *et al.* 2010). Mihret and Yismaw (2007, 470) view IA effectiveness as a *"dynamic process that is continuously shaped by interactions"* especially between the CAE and SM whose support is seen as a critical success factor. We study that relational dimension between CAEs and SM. We interview both the CAE and SM in the same organization, which is the particular contribution of this study. This is one of very few studies of IA effectiveness where interviews are conducted with both the CAE and SM in the same organization, complementing Sarens and De Beelde (2006b) and Soh and Martinov-Bennie (2011) who study this relationship in a Belgian and Australian setting, respectively. This is the first study in the German context where CAEs and SM in the same organization are interviewed.

We wish to break new ground with this paper as *"nothing is quite so practical as a good theory"* (Lewin, K., 1945; cited in Van de Ven, 1989: 486). We apply for the first time role theory (Kahn *et al.* 1964) in combination with the theory of relational coordination (Gittell 2006) to the research context of IA effectiveness. We see significant potential in applying these theories in combination in the studying and understanding of this still largely enigmatic subject matter. We will introduce and apply these new theories in this paper, and we will demonstrate that the two theories in combination are particularly well suited for the subject matter and purpose of this research. These combined theories may have the explanatory power to become a more widely applied and accepted theoretical framework in the research of IA effectiveness and the overarching context of governance, whether on a micro-level (company) or macro-level (country, continent).

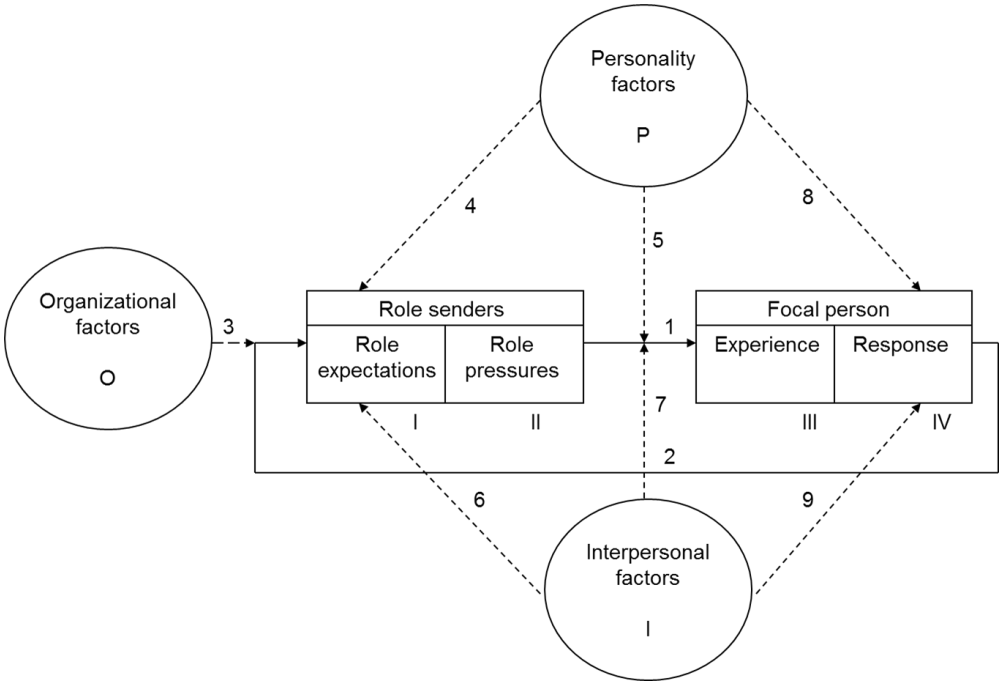
The dynamics between the building blocks suggested by Kahn *et al.* (1964) – that is, organizational factors, personality factors and interpersonal relations - frame the setting. We regard the theory of relational coordination (Gittell 2006), as particularly suitable for this case study research into the dynamic relationship between CAE and SM. Relational coordination is expected to be most effective when it is carried out through frequent, timely and problem-solving communication that is supported by relationships between actors that have shared goals, shared knowledge, and mutual respect (Gittell 2006, 85).

The theories are seen as particularly appropriate to explore IA effectiveness, as the relational dimension is the focal point, being the inter-role factors in the dynamics of the interaction between CAE and SM.

2.1 Role theory (RT)

Prior academic literature points to the significance of IA in helping organizations to achieve objectives (Dittenhofer 2001, also Mihret *et al.* 2010) which corresponds with the definition of IA (IIARF 2011a, 2). Objectives are achieved by people. RT views the organization as *"an open system, a system of roles; it consists of continuing, interdependent cycles of behavior, related in terms of their contribution to a joint product"* (Kahn *et al.* 1964, 388).

Figure 1: Kahn *et al.* (1964), Role Theory (RT)



Thus, the organization is viewed as a system of roles and cycle of behaviors, and roles are defined in terms of its relationships to others. If we define the role without mentioning its connections, *"there is virtually nothing left"* (Kahn *et al.* 1964, 389). Reflecting on inter-role factors is what this study focuses on.

Role expectations are influenced by at least three factors[3]: organizational factors (O),

[3] In Kahn *et al.* (1964, 30 and 378) the abbreviations used were A, B and C.

personality factors (P), and interpersonal factors (I). Organizational factors (O) are comprised of variables like size, financial base, industry, listing, and ownership. Personality factors (P) refer to a person's propensity to behave in certain ways, as well as their motives and values, sensitivities, fears, and habits. Interpersonal factors (I) refer to the pattern of interaction and relationships between people in an organization, including aspects of relationship like power (ability to influence), respect, trust or lack of trust, dependence, and style of communication (Kahn *et al.* 1964, 31-33).

These three factors (O, P and I) are highly relevant to the study of the phenomena of IA effectiveness. Building block (O) embodies the organizational impact (e.g., Abdolmohammadi and Sarens 2011, Chanchani and MacGregor 1999, Sarens and Abdolmohammadi 2011). The IA service providers are represented by building block (P), the personality factors (e.g., Rittenberg and Anderson 2006, Sarens 2009, Van Peursem 2005). The relational dimension between the IA service providers and their key stakeholders is captured by building block (I), interpersonal factors. Namely the relationship between IA and SM (Cohen and Sayag 2010, Halimah et al 2009, Mihret and Yismaw 2007, Sarens and De Beelde 2006a and 2006b) is regarded as paramount in the German context, as SM is typically regarded as the chief stakeholder in IA services.

Thus, the three building blocks of RT (Kahn et al 1964) incorporate the provider of IA services and its customer/s within a specific organizational context. Factor (I) addresses the central subject of this research project, as the perspectives of SM and the CAE and their relationship and interaction are given particular attention. Factors (O) and (P) are discussed but not fully examined in this paper.

Ahmad and Taylor (2009) apply RT in studying IAF in Malaysia and conclude that role ambiguity and role conflict negatively affect the independence of internal auditors. RT defines role ambiguity as occurring when it is unclear what is expected and whose expectations shall be met (Kahn *et al.* 1964, 24). RT defines role conflict as occurring when two (or more) sets of pressure cannot be simultaneously served (Kahn *et al.* 1964, 19). Such paradoxical situations could be more frequent in practice than one may expect.

DeZoort and Lord (1997, 67-68) provide a taxonomy of individual pressures including organizational pressures (workload pressures, feedback pressure, and social influence pressures, e.g., compliance, conformity, and obedience) and role characteristic pressures,

especially role ambiguity, that "refers to pressure resulting from not understanding one's exact role within the organization", and role conflict, i.e., "the pressure derived from the incongruity of expectations associated with a role."

Brunsson (1986 and 1993) shows that organizations that are good at reflecting inconsistencies may live longer, so inconsistencies may serve a useful purpose[4]. Cameron (1986, 549) discusses the dilemma of finding a balance between opposing values, such as when one seeks proactivity and entrepreneurship along with stability and control. Van Peursem (2004, 379 and 390) reflects on the nature of the internal auditor's role dilemma and role confusion and alerts us to the dangers of a jack-of-all-trades image of internal auditors. Arena and Jeppesen (2012) point to the inconsistencies internal auditors face, such as those between control and value creation and between compliance and business improvement, and those that are due to the dual roles of providing assurance and consulting services (also, e.g., Anderson 2003, Lenz and Sarens 2012).

In the context of this research, the focal person is the CAE, and the role sender is SM. Role senders have expectations regarding the way in which the focal role (i.e., the CAE's role) should be performed ("what the person should do, what kind of person he should be, what he should think or believe, and how he should relate to others", Kahn et al. 1964, 14). In the model, it is generally assumed that role expectations are communicated, which the model then views as a reference (Kahn et al. 1964, 27). The case studies show how realistic or vulnerable that assumption can be. It is conceivable that role expectations are directly expressed or disguised in such a way that some CAEs may possibly be uncertain of what is expected.

Role senders have perceptions regarding the way in which the focal person is performing. They correlate those perceptions with their expectations and may exert pressure to make the performance of the focal person congruent with their expectations. That interaction is assumed to be cyclic and ongoing. Each role is defined in terms of its relationships to others. The four boxes in figure 1 (I to IV) represent events that constitute a so-called "role episode", that is one complete cycle of role sending (by SM), a response by the focal person (the CAE), and the effects of that interaction on the role sender (Kahn et al. 1964,

[4] As Brunsson (1986, 171) observes "organizations may reflect inconsistent norms by systematically creating inconsistencies between talk, decision and products. They can talk in consistence with one group of norms, decide according to another and produce according to a third."

26). If there is a conflict, ambiguity, or tension between the focal person and his or her role sender/s, an adjustment is expected. Thus, the model is cyclic and dynamic.

When interpersonal factors (I) are studied in practice, the theory of relational coordination (Gittell 2006) offers complementary explanatory power.

2.2 Theory of Relational Coordination (RC)

RC is theorized to be especially effective under conditions of task interdependence, uncertainty and time constraints and it has not been studied very often in project settings but rather it has been studied in repeated work processes like patient care (Gittell 2002, Gittell *et al.* 2010) and flight departures (Gittell 2001). The process (methodology) to take care of patients is standardized, but the specific treatment of each patient is different.

The application of Gittell's theory is particularly well suited in the context of IA as IA has a degree of "repeated work processes". The work of IA is standardized as there are defined processes (methodology) to follow, but the content, the context and specifics of the audit mission are always different.

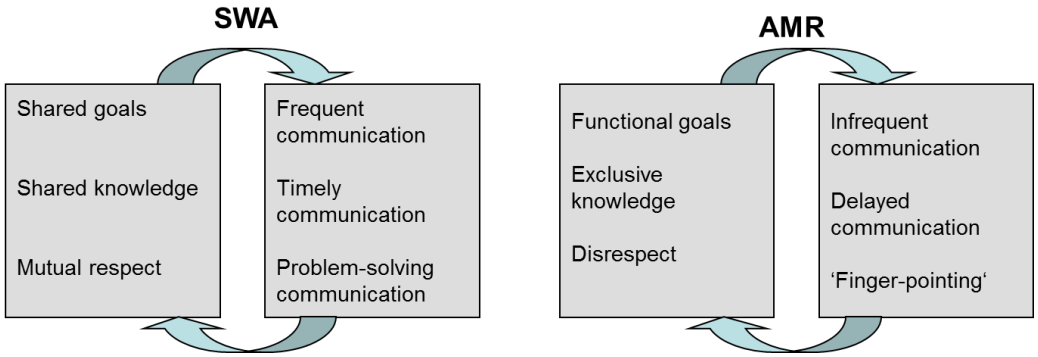
In addition, especially in the form of the adaptive audit approach (Leitch 2008, 122-124) IA not only includes routine processes but it also makes connections, it typically crosses functional silos. IA's typical environment is characterized by uncertainty that demands judgment based on evidence; if things are straightforward and crystal clear to everyone no IA would be needed. IA typically operates under some time pressure also to complete the assignment in due course – and some risks may need urgent 'treatment'.

We do not see modern IA as purely repetitive type of work, largely characterized by mechanical and checklist driven activities which may risk putting form over substance. Quite the contrary, to get most value out of IA, we see value in the concept of adaptive audit (Leitch 2008, 122-124) which clearly puts substance over form, it is highly risk focused, that is, *"respond to what you find and focus on the highest areas of risk and most cost-effective controls."*

Gittell (2006) develops RC while studying the flight departure process of Southwest Airlines (SWA) and American Airlines (AMR), which is characterized by high levels of

task interdependence, uncertainty, and time constraints:

Figure 2: Gittell (2006), Relational Theory of Coordination (RC)



Gittell (2006) engages in sampling based on maximizing differences by shadowing and interviewing staff at work. While SWA describes the model of an effective flight departure process, AMR describes the opposite case.

In the case of SWA, goals were shared, everybody cared, there was a sincere team effort across all functions and a shared understanding of the overall work process, and employees not only knew what to do but also how the overall process worked and why it worked that way, as suggested in the observation *"we all succeed together – and all fail together"* (Gittell 2006, 79). Moreover, SWA was characterized by frequent and timely communication that was focused on problem solving rather than blaming when things went wrong, and employees treated each other with respect.

In contrast, the AMR staff expressed frustration about the lack and lateness of the communication they needed from colleagues to perform their tasks. *"Naming and shaming"* was used when something went wrong. There were huge status boundaries between flight and ground crews and between ground staff; for example *"gate and ticket agents think they're better than the ramp"* (Gittell 2006, 83). There was very little awareness of the overall process, and the majority of staff did not seem to care about what happened or the outcome of the overall process, *"even if the walls fall down, as long as they get their check"* (Gittell 2006, 80).

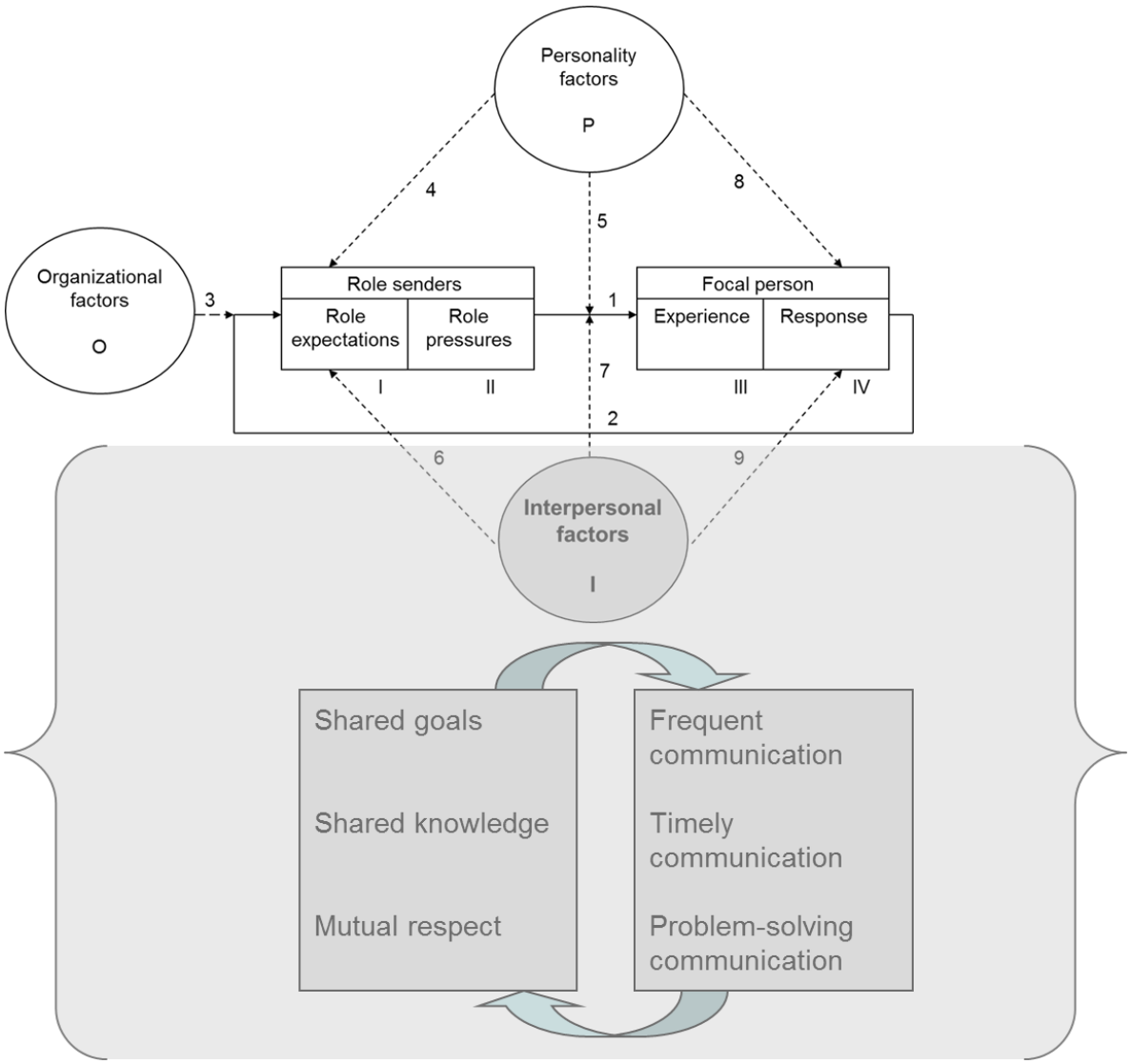
Gittell's RC (2006) posits that effective coordination occurs through frequent, timely, problem-solving communication, supported by relationships between actors with shared goals, shared knowledge, and mutual respect (Gittell 2006, 85). Gittell's RC (2006) is

employed in combination with RT (Kahn *et al.* 1964) as the theoretical bases that provide the lenses used in studying IA effectiveness.

2.3 RT and RC combined

RC (Gittell 2006) complements and strengthens RT (Kahn *et al.* 1964) as far as interpersonal relations are concerned. This enhancement is best illustrated when the two theories are merged as shown in figure 3:

Figure 3: Role Theory (RT) and Relational Theory of Coordination (RC) combined



The case study data generated is viewed and analyzed by applying the combined model of RT and RC: while RT (Kahn *et al.* 1964) is the overarching framework, RC (Gittell 2006) is used when the dimension of interpersonal relationships between the CAE and SM, the

focal subject of this study, is examined.[5] Such an examination can show that the interaction between SM and the CAE, that is, the role sender and the focal person in RT's terminology (Kahn *et al.* 1964, 26), may also be characterized by the term that Carlzon (1989) introduced to management and marketing: *"moments of truth".* Moments of truth are moments *"that the passengers aren't likely to forget", those "that ultimately determine whether [an airline] will succeed or fail as a company"* (Carlzon 1989, 3 and 64). Similarly, as this study shows, when SM and the CAE interact, there can be such moments of truth that determine whether the CAE will ultimately succeed or fail.

With this study we wish to find out whether RT (Kahn *et al.* 1964) in combination with RC (Gittell 2006) can provide insights into the effectiveness of IA and may represent a promising combination of theories for future studies. Framed by Kahn *et al.* (1964) and supplemented by Gittell (2006), the present study addresses three research questions (RQ).

RQ1: Does role theory (Kahn et al 1964) formed by the dynamics of organizational, personality and interpersonal factors as building blocks provide insights into the effectiveness of IA, especially when it is complemented by the theory of relational coordination (Gittell 2006)?

RQ2: How do shared goals (vs. functional goals), shared knowledge (vs. exclusive knowledge), and mutual respect (vs. disrespect) between the CAE and SM influence the effectiveness of the IAF?

RQ3: How does frequent (vs. infrequent), timely (vs. delayed), and problem solving communication (vs. finger-pointing communication) between the CAE and SM influence the effectiveness of the IAF?

These three research questions are addressed with the use of eight case studies. Before presenting the results of the research in section 4, the methodology of data analysis is presented in the next section.

3. Methodology

Some extant literature has addressed IA effectiveness, and many prior studies have

[5] The term interpersonal factor is used synonymously with inter-role factor as that is what RC is reflecting.

pointed out that interpersonal relations between the CAE and SM matter (e.g., Arena and Azzone 2009, Cohen and Sayag 2010, Cooper 1994, and Norman *et al.* 2010). However, only very few studies have included both stakeholders in their case study design (Sarens and De Beelde, 2006b, and Soh and Martinov-Bennie, 2011). As *"only practice contains all theory"* (Kappler 1988), we chose multiple-case study research as the empirical inquiry technique with which to investigate the subject matter in depth and within its real-life context, and find out what is happening in practice. Case studies are most likely to illuminate the research questions (Yin 2009). The approach was *not* to search for typical (generic) cases of IAFs as there is no typical (generic) IAF or organization and no criteria to tell what that phenomenon should look like.

Proceeding per Gittell (2006), we seek to study extreme cases[6] in order to review both ends of the continuum – in our context - the comparatively very strong and effective at one end and very poor and ineffective cases at the other. We contend that qualitative research on extreme cases (which is unique in the context of researching IA effectiveness) will lead to new, relevant, and valuable insights as we *"want to look for contradictory or opposite cases so that we might find examples of how concepts vary when conditions change"* (Corbin and Strauss 2008, 81). We expect that extreme cases may illustrate differences more clearly than homogeneous cases would. As acknowledged in the limitations, the sample base may include disproportionate numbers of relatively strong cases of IAFs, as in order to get their SM to participate in the study there has to have been a minimum level of cooperation and coordination between the SM and the CAE.

3.1 Semi-structured interviews with CAE and SM

In Germany, the CAE usually reports to a member of the SM team. Direct reporting lines of CAEs to the supervisory board ("Aufsichtsrat") are not yet common in the two-tier board system in Germany, so no interviews were conducted with members from the supervisory board. Interviews were conducted with both, the CAEs and the members of their SM teams who oversee the IA function. Two questionnaires were used. The questionnaire for the CAE contained twenty-eight questions (Appendix B), and the questionnaire for SM had twenty-three questions (Appendix C)[7].

[6] Revelatory case (Yin 2009, pp. 48-49) study research is attempted in multiple-case design.

[7] The German questionnaires translated into English are attached to the paper as the audiences of this paper

The semi-structured interviews were conducted from March to June 2011. The interviews were recorded unless the interviewee preferred that the discussion not be recorded. When interviews were recorded, the tapes were transcribed into Word documents. When the interviews were not recorded, extensive summary notes of those interviews were written. The transcript or the summary notes, as applicable, were sent to the respective interviewee for verification. Eight organizations (cases) were studied using interviews with the CAE and a member of SM in each firm. All interviewees were told that their responses would be held in strict confidence. The sixteen interviews generated about sixteen hours of recorded time and 128 transcribed pages.

3.2 Data analysis process

Since the first interview on 1 March 2011, an interview tracker was updated that summarizes specifics of the organization and the interviewees and captured additional notes (if any) about the interview, its content, the process, further impressions, and anything else that was noticed that could be helpful in interpretation beyond the recorded verbal communication. As interviews were conducted with individuals, the data collection source is the individual interviewee, either the CAE or the senior manager. We used software to help explore the phenomena hidden in the qualitative data (Atlas.ti 2004).

When the qualitative data was analyzed using Atlas.ti (2004) as the qualitative research tool, the research process was deductive at the beginning. The so-called primary documents in the hermeneutic unit that contains all data were coded in line with the terminology suggested by RT (Kahn *et al.* 1964): organizational factors, personality factors, and interpersonal factors. The last of these building blocks was expanded according to the terminology suggested by RC (Gittell 2006). At the same time, the research remained open to serendipity – to finding something without searching for it, thereby discovering the unexpected. Consequently, additional codes were added during the analysis that complemented and enhanced the theoretical framework chosen at the onset. Therefore, the research process applied was predominantly deductive, as we intended to use the categories that applies RT (Kahn *et al.* 1964) and RC (Gittell 2006) to the subject matter of IA effectiveness. Nonetheless, the element of inductive research gained its share of attention throughout the data analysis process; therefore we regard the

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are domestic and international. The corresponding author upon request can provide two original questionnaires in German language.

methodology primarily as deductive but as complemented by what we call “deductive-inductive dialogue”, - a term that summarizes well what we actually did.

4. Results

We identify common patterns and differences between the comparatively more and less effective IAF that emerge. The next section discusses organizational, personality, and interpersonal factors, building on RT (Kahn *et al.* 1964) supplemented by RC (Gittell 2006) in order to distinguish between the *top half* of cases (A, D, F, G and H) and the *bottom half* of cases (B, C and E) as a result of the interview process.

4.1 Organizational factors (RT, factor O)

Empirical theory suggests that organizational factors matter when studying IA effectiveness, e.g., the size of the IAF is driven by firm size (Sarens *et al.* 2010). Firm size is positively associated with the extent to which firms invest in their IAF (Carcello *et al.* 2005, and Goodwin-Stewart and Kent 2006). Due to the limited amount of cases studied, in this research, no statistically valid analysis regarding firm size is robust.

IA effectiveness is understood to be positively related to the size of the IA team, its resources, and competencies (Arena and Azzone 2009, 45). It can also be reasonably expected that the person to whom the CAE reports (positioning), the size of the firm, the size of the IAF, whether IA is required by law, and whether a firm is listed may influence the effectiveness of IA.

All eight case studies are of organizations headquartered in Germany:

Table 1: Organizational factors

Case	Listed	Industry	Revenue €	Employees
A	No	Telecommunications	1.2-6bn	10,001-25,000
D	No	Manufacturing and Engineering	1.2-6bn	5,001-10,000
F	No	Food and Beverage (F&B)	600M-1.2bn	1,001-5,000
G	Yes	Health care, lfe science, pharmaceuticals	6-12bn	25,001-50,000
H	No	Logistics and Mobility	over 12bn	over 50,000

Case	Listed	Industry	Revenue €	Employees
B	Yes	Health care, lfe science, pharmaceuticals	241M-600M	1,001-5,000
C	No	Manufacturing and Engineering	1.2-6bn	5,001-10,000
E	No	Health care, lfe science, pharmaceuticals	61M-240M	1,001-5,000

Following the qualitative study, cases A, D, F, G, and H are clustered in the top half, and the cases B, C, and E are clustered in the bottom half. In all eight cases investigated, the CAE reports functionally to a member of SM - in five cases to the Chief Executive Officer (CEO) and in three cases to the Chief Financial Officer (CFO)[8]. No further analysis was carried out on the influence of the reporting line and any differences that may ensue.

The organizations in cases B, G, and H have established an IAF, thereby satisfying legal requirements. Cases B and G are listed firms. Case H is partly owned by the state.

The companies operate in industries that include telecommunications, health care, manufacturing and engineering, food and beverage, and logistics and mobility. They have revenue ranging from EUR 61 million to over EUR 12 billion. Their number of employees range from just over one thousand to over fifty thousand.

The IAFs studied vary from single-employee IAFs (cases B and F) to an IAF with over one hundred internal auditors (case H). The size of the IAF seems to matter in the sample base, as the only two IAFs with double-digit (case G) or triple-digit (case H) numbers of internal auditors are grouped in the top (more effective) half. The two firms with the lowest number of staff and the lowest revenue (cases B and E) are in the bottom (less effective) half. Case C, an organization with over five thousand employees and revenue exceeding EUR 1.2 billion, is also grouped in the bottom half. There were notable differences among small IAFs that became particularly clear in a discussion of the dimension of interpersonal relationships (in section 4.3).

[8] In case C, the CAE reports to the Deputy-CEO. In case D, the CAE reports to the CEO, who is acting as CFO. In case E, the CAE reports de facto to the CFO.

Before discussing the building blocks of personality and interpersonal relationships, we further reflect on organizational factors of the cases, but they are now sorted into two groups of more or less effective IAF, that is, the top and bottom half. This clustering highlights the different intensities of IA effectiveness as suggested by the lenses of RT (Kahn *et al.* 1964) and RC (Gittell 2006).

4.1.1 Organizational factors, top half

Five out of eight cases, including the cases A, D, and F, were clustered into the top half. The interview data of these three cases showed that all three are privately owned enterprises that belong to the group of *"hidden champions"* (Simon 2009, 15). Hidden champions are firms that are champions in their field, number one, two or three in their global markets or number one their continents, they are market leaders in the industry in which they operate in. Their revenue is typically below US-D 4 billion, but they also prefer to be hidden, as they have a low level of public awareness because they tend to be active in business-to-business markets and to have limited or no interaction with the end consumer. According to Simon (2009, 154), *"the strategy of most hidden champions is directed toward high value to customers, not toward low prices."* High value and high prices fit well together, and they fit even better when they are supplemented by low cost, a *"hybrid strategy"* (Simon 2009, 209) that some hidden champions pursue.

Simon (2009, 14) reports that one CEO said, "We have cherished our anonymity for years and feel very comfortable about it. Nobody has noticed our niche", which is evidence that hidden champions prefer to remain hidden so to protect their competitive advantage. Consequently, while those firms may represent a rich source for research and for the phenomena of IA effectiveness, *"hidden champions remain a virtually unexplored source of knowledge"* (Simon 2009, 1). Therefore, having obtained some insights into IA practices within hidden champions is an asset of this study.[9]

Some specifics of the corporate culture in these firms influence IA effectiveness. According to Simon (2009, 267 and 284), *"Most hidden champions have a culture of high performance"* and *"Their values are based on conservative principles such as hard work, strict selection, intolerance of underperformance, low sickness rate, and high employee*

[9] A single-case study that research IA practices within hidden champions (Simon 2009) is recommended, as more revelatory potential is expected. The challenge can be that such organizations may want to remain hidden.

loyalty and most hidden champions are based in smaller towns". They are lean not only at the top, but on all levels. They have a culture of intolerance in terms of bad performance and shirking. They prefer small units, as they believe that high performance is then easier to achieve and that the employees are closer to the results of their work and identify more strongly with them. This view is well supported by another CEO, who states, *"More can be achieved with a highly motivated team working on old machinery in a shack than with an unmotivated group with the latest machinery and premises"* (Simon 2009, 260). Peter Drucker concurs in a description of the challenge to management as being *"about putting people in a position to perform as a group by giving them goals and values, as well as continual learning and development opportunities"* (Simon 2009, 260).

According to Simon (2009, 261f.), *"people are increasingly unwilling to work for money alone. They expect work to provide more meaning, to bring enjoyment, and to satisfy overarching goals and values."* The aspect of shared goals and the importance of corporate culture are understood to apply particularly to *"more intellectually demanding work"* as *"experts can ultimately be managed only by motivation and targets."* These reflections correspond to the world of CAEs and IA and closely resemble the ingredients of RC as Gittell (2006) describes it in an analysis of the positive sample case of SWA.

Additional profiling observations about each of the sample cases, focusing on organizational factors, the first building block studied, could be useful. In *case A*, the organization generates revenue exceeding EUR 1.2 billion. The company, which operates in the field of electronic interfaces, has achieved worldwide technology leadership. Its IAF consists of a team of five, who also perform risk management. The CAE reports administratively to the CFO, and the owner of the company, who requests regular reviews of IA reports and findings is regarded as the ultimate "boss" to whom the CAE reports. The CFO currently seeks ways to better use the IAF more effectively as a training ground for future managers. The company is also currently investigating whether a certain period of service in IA should become mandatory for future leaders before they are promoted to an SM position. That consideration also reflects well on the CAE in charge.

In *case D*, the organization generates revenue that exceeds EUR 1.2 billion. Applying a narrow definition of the relevant market, the company is in the truck and trailer business, has streamlined its value proposition with a strong focus on cost and productivity. The IAF's team of two also performs risk management and compliance. The CAE reports to

the CEO, who also acts as CFO and who is regarded as the prime customer. The CAE reports formally and directly to the finance and audit committee of the supervisory board, but there is no interaction other than the annual presentation of the IA activity. The IAF was established in 1999 and has been maintained since then. At the time it established the IAF, the privately owned company was considering an initial public offering, but that plan was eventually cancelled. According to the CAE, effective internal auditing requires not only an IA charter, a risk based approach, a high degree of independence, documentation and follow-up of findings, but, most importantly, *"knowing what makes the company tick"* – that is, insight into how things are done, informal powers and structures, and the personal perceptions of the actors in their roles and context.

In *case F*, the organization, one of Europe's leading producers of fruit juice, generates revenue that exceeds EUR 600 million. The IAF consists of a one person, the CAE, who has been tasked to lead a GRC (Governance, Risk and Compliance) improvement program. The CAE reports to the CFO, who interacts with the chair of the audit committee on IA-related matters.

While *case A* has a CAE with direct and frequent direct access to the owner of the organization, in cases D and F there is limited or no interaction at all with the supervisory board or audit committee. This issue is considered in detail in the discussion of interpersonal factors (section 4.3).

Cases G and H are also grouped into the top half. In *case G*, the listed organization generates revenue that exceeds EUR 6 billion. The IAF has staff of fourteen people, and the CAE, who reports to the CEO and is a vice president, also oversees risk management and reports bi-annually to the audit committee about risk management, and annually on IA. The SM member interviewed refers to the specific company culture, which he characterizes as including constructive interpersonal dealings, which also affect IA and its interaction in the organization.

In *case H*, the organization generates revenue that exceeds EUR 12 billion. The IAF is sizable, with staff of over one hundred internal auditors. The CAE reports to the CEO and updates the audit committee regularly.

4.1.2 Organizational factors, bottom half

Three cases were grouped in the bottom half. Two of these cases, B and E, are organizations that are relatively small in terms of revenue and staffing. Case C is also in the bottom half in contrast to case D. While *prima facie* both companies look very similar as they operate in the same industry and have a similar firm size in terms of revenues and staff, they are clearly distinguished by their particular features that emerge from the interviews.

In *case B*, the listed organization generates revenue that exceeds EUR 240 million. The IAF contains one person, the CAE, who reports to the CFO. The CAE reports annually to the audit committee on IA. The IA plan is not risk-based; there is a separate risk management department but that department and IA are like "ships passing in the night." IA does not refer to what risk management is doing or build on it; they are essentially two parallel organizations, so there is clearly no integration.

In *case C*, the organization generates revenue that exceeds EUR 1.2 billion. The CAE heads a team of four, but only about one full-time-equivalent works on IA assignments, while the remainder have shifted focus to customs and foreign trade assignments. The CAE reports to the deputy CEO and has no contact with any oversight body. The CAE believes that the CEO (who is also the owner of the company) does not have an interest in IA and that the CEO views it as "an administrative thing".

In *case E*, the organization generates revenue that exceeds EUR 60 million. The CAE oversees a team of two and reports officially to the CEO, but *de facto* he reports to the CFO. The CAE reports to the audit committee annually.

Among the organizations in the bottom half, only case C has no access at all to the oversight body. We considered other aspects of cases B and E to substantiate the clustering chosen. The clustering of cases B and E in the bottom half is further discussed and is more easily appreciated in section 4.3 (interpersonal factors). The next section addresses the impact of personality factors on IA effectiveness.

4.2 Personality factors (RT, factor P)

The dimension of personality is an essential factor (Van Peursem 2005, Rittenberg and

Anderson 2006) in IA effectiveness. Mihret *et al.* (2010, 240) emphasize the significance of an *"independent frame of mind [that] should manifest itself in IA's ability to make the 'tough' recommendations without fear or favour."* Similarly, Soh and Martinov-Bennie (2011, 614) draw particular attention to the importance of the CAE's characteristics, suggesting "a good CAE is able to work with other stakeholders in the organization and is not afraid to voice his or her opinion even in controversial situations."

This section is primarily descriptive and the descriptions of each of the CAEs are largely demographic:

Table 2: Personality factors

Case	Key point	Age	Tenure	Education	IA designation
A	Calm, sober, and factual, self-critical	c 40-45	2 years	University	No
D	Down-to-earth character, pragmatic	c 50-55	25 years	University	No
F	Humble, learning	c 50-55	25 years	University	No
G	Particularly articulate, concise	c 40	7 years	University	Yes
H	Charismatic <--> arrogant	c 45	2 years	University	No

Case	Key point	Age	Tenure	Education	IA designation
B	Thrives on positive feedback from auditees stating "the desire to be loved or valued is very human"	c 45	3 years	University	No
C	Entrenched, almost given up	c 45	16 years	University	Yes
E	Low ambition level, last stop before retirement	c 45	1 year	University	No

Observations are again clustered in such a way as to distinguish the top half and the bottom half of the sample base.

4.2.1 Personality factors, top half

In *case A*, the CAE is in his mid-forties and a university graduate. He gained experience in a consulting firm and as an operations manager before joining his current firm as CAE two years ago. He comes across as calm, sober, and factual and does not seem to require or thrive on positive customer feedback. He appears to be self-critical as he reflects on his role and impact in the organization. He has no IIA designation and sees no value in pursuing such studies. He deliberately does not recruit "career auditors" as he believes that internal auditors should move out of IA after maximum of six years because of a

lowered contribution over time. The CFO presented the very same view on the tenure of internal auditors in the IAF when he was interviewed separately.

In *case D*, the CAE is about fifty years old and a university graduate. He has been with the company for about twenty-five years. In the first half of that period, he had roles in finance and controlling, but he has been the CAE since 1999. He has no IIA designation and has no intention to study for it. The CAE expanded the scope of IA services subsequent to the revision of the German Accounting Law Modernization Act (BilMoG 2009), when he suggested improvements to the governance framework of the company. Since then IA has also become responsible for risk management and compliance. The CAE emphasizes that supply-led change in observing, *"There was no customer asking for the iPod from Apple before it was invented."* That observation points to the possibility that it is not only the customers of IA services that influence its effectiveness, but also that there is much room for the CAE to maneuver and influence IA's scope and status in an organization. That relationship would then represent a two-way street. The CAE is a down-to-earth character, and there are no achievements or successes of which the CAE is particularly proud, a message he conveyed with a shrug of the shoulders. He has no ambitions to seek exposure to the audit committee beyond what is currently demanded.

In *case F*, the CAE is in his mid-fifties. He has been with the company for over twenty-five years, having started as a trainee and gaining experience in operations before taking on growing roles in finance and controlling, including a CFO position for ten years when he was sent to a major subsidiary abroad. Upon his return to the German headquarters in 2010, he took on the assignment as CAE. He has no IIA designation but is considering studying for one. According to the CFO, it is critical that the CAE understand the business and be alert to the risk that, if IA were dogmatic, it would easily fail. The issues identified should make business sense, must be balanced in terms of effectiveness and efficiency, and need to fit the respective business context, while addressing what truly matters. That expectation reflects well on the CAE in charge, who views himself as sort of *"a hinge, a connector, a relation facilitator"* as he regards himself as instrumental in sharing best practices in the company.

In *case G*, the CAE is about forty years old and a university graduate. Prior to working in IA, he worked as a consultant. He has been with the company as CAE for about seven years. He is qualified as a chartered accountant and has various IA designations, which he

regards as a "hygiene factor". He sees personal attributes as important, especially highlighting *"professional sociability"* as a key personality factor, as their assignments swiftly succeed another, internal auditors should be able to establish new working relationships fast. This CAE is particularly articulate, and his responses are very concise. That there is no room for waffling in his IA reports is highlighted when he points out, "we do not write about positive things". Since summer 2011, the CAE has been promoted to Country Manager and tasked to manage the company's business affairs in a central Eastern member state of the European Union.

The CFO of case G stresses the importance of internal auditors' having a keen perception and *"spine"* standing up for their findings when presenting them to the auditee. Internal auditors also need a passion for detail and processes, and particularly good communications skills, which he calls *"Fingerspitzengefühl"* – that is, being skillful when dealing with people, establishing relationships, and asking the critical questions that matter in an intelligent fashion. That metaphor, umbrella term that characterizes the role of internal auditors deserves further reflections. The CFO views dealing well with people and seeing quickly how things fit together as the particular art of a talented internal auditor. The German term Fingerspitzengefühl, which has been appropriately borrowed by the English language, literally means *"finger tips and feeling"* but it more figuratively means having flair, intuition, and a sure instinct.

In *case H*, the CAE is in his mid-forties and a university graduate. Prior to working in IA, he worked in external audit. He is qualified as a chartered accountant, but he has no IA designation and no intention to obtain one. Before taking on the CAE post at his current organization about two years ago, he was CAE for about nine years in another large listed firm in Germany. He is currently one of the top fifty employees in a huge organization. The CAE comes across as strong, and while some may perceive his style as arrogant, others may see it as charismatic. He gives the impression of being very well anchored and respected in the organization and possibly feared to some degree, an aspect that he alludes to when he refers to managing directors of subsidiaries possibly being asked to leave the company depending on the severity of IA findings or in case of inadequate and delayed addressing of major findings.

Only one of five CAEs who are regarded as heading comparatively more effective IAF has an IA designation. This issue may deserve further attention, as professional

certifications are used in academia as criteria to approximate to competence (e.g. Krishnamoorthy 2002). This observation also points to questions concerning the practical usefulness of and the value derived from certification. In some cases having an IA designation could be over-valued and erroneously associated with competence.

4.2.2 Personality factors, bottom half

In *case B,* the CAE is in his mid-forties and a university graduate. He has no IA designation. He views himself as a career auditor, as he has only worked in IA and has been three years in his current firm. He thrives on positive feedback from auditees, stating, *"the desire to be loved or valued is very human."* He is reluctant to call his one-man service an "audit" as he views his role as sharing best practices, an ambition he underscores by saying that "positive things must be written in the report also."

In *case C,* the CAE is in his mid-forties and a university graduate. He holds an IA designation. He has been CAE of his current firm for about sixteen years. He admits that he is chairing a subpar IAF as he has only about one full-time equivalent rendering IA services. He seems to have accepted that situation; he is in a rut and almost resigned to the situation.

In *case E,* the CAE is in his mid-fifties and a university graduate. He has no IA designation. He has been in IA for fifteen years and has been CAE in his current firm for over a year, working on a temporary contract until 2013, when he will be fifty-seven years old. He is hoping to get a three-years extension of his contract from management in order to come close to retirement age. He displays a relatively low ambition level and views this engagement as his last stop before retiring.

The CFO of case E describes good internal auditors as *"swimming in the organization."* They *"know what is happening in the company, and speak with everyone, every function, and on all levels in the organization."* The subpar internal auditors may often "have lunch alone". The best internal auditor he ever had was unchallenged in his post. He left the company for a bigger and more complex IA assignment. In this organization, contracts of subpar internal auditors are simply not extended, which supports the conclusion that organizations ultimately have the IA services they want to have. Therefore in case E, the selection process happens over time as internal auditors that fit the context join and stay,

and internal auditors that do not fit or no longer fit the context may not join in the first place, may adapt, or may be asked to move on.

The metaphor *"swimming in the organization"* is a colorful picture of the role of internal auditors that may deserve further reflection. Following are some preliminary considerations that build on what was already shared by the interviewee:

- IA is an activity, so go swimming, swim with the current or against the current (raise the red flag) - whatever is deemed necessary at the time - but do not remain at the pool edge watching what others are doing.

- IA thrives on accountability and learning, so accept drowning as a risk of taking a stance without fear of favor. Constantly aim to improve.

- IA is nurtured by successful interpersonal relations, so be part of the same pool, the same organization, and be a critical friend who liaises with colleagues on all levels, rarely *"having lunch alone."*

The interpersonal dimension should now be investigated, so we turn to the third building block of RT (Kahn *et al.* 1964), which is examined as being supplemented by RC (Gittell 2006) as a theoretical framework.

4.3 Interpersonal factors (RT, factor I)

The relationship between the CAE and key stakeholders is a key determinant of IA effectiveness and helps to sort the wheat from the chaff – that is, it helps to distinguish relatively *more* effective IAFs from the relatively *less* effective IAFs, thereby addressing RQ2 and RQ3.

All cases studied in this third and final building block of role theory (Kahn *et al.* 1964) are viewed through the lenses of the theory of relational coordination (Gittell 2006). For clarity, all cases are first presented one by one and then cross analyzed at the end. Most relevant excerpts of the source data that were generated through interviews and then transcribed and uploaded into the hermeneutic unit of the qualitative data analysis tool (Atlas.ti 2004) can be made available to facilitate other scholars' efforts to come to

similar conclusions. A snapshot of the source data[10] that supports RQ2 is provided in table 3.

Table 3: Interpersonal factors, top group (cases A, D, F, G and H)

Case	Key point	Key quote
A	The CAE in case A benefits from the owner's particular interest in IA work.	The CFO states "we work problem-oriented. We agree on actions, that he [the managing director of sales] then implements in his organization, and I implement in mine".
D	The CAE in case D benefits from clear and aligned expectations from the CEO.	The CEO wants the CAE to have no fear or favor and says, "the successful CAE needs to maintain his independence, needs to work as objectively as possible and remain neutral, and must be able call a spade a spade."
F	The CAE in case F benefits from strong support by the CFO and is entrusted with leading a governance improvement program.	The CFO expresses his appreciation, saying, "This is a clear sign of the high trust we have in him."
G	The CAE in case G personally presents all IA work to SM, making management feel safe.	IA provides a sense of comfort, especially when there are leadership changes; as the CFO puts it, "IA provides the feel-good factor when reviewing matters independently and giving reassurance that things are in good order."
H	The CAE in case H helps SM and the supervisory board to discharge their oversight responsibility.	To underpin his appreciation of IA as "part of the system of checks and balances," the CFO stated, "if there were no IA someone ought to invent it."

Cases in the top half are analyzed and discussed next.

4.3.1 Relational coordination, top half

Cases A, D, F, G, and H are clustered into the top half as samples that represent relatively more effective IAFs.

The CAE in *case A* benefits from the owner's particular interest in IA work.

Communication between the CAE and key stakeholders happens frequently, is timely, and focuses on problem-solving.

The CAE has a great deal of interaction with SM and many moments of truth, both of which give him comfort with his role and IA effectiveness. The dialogue between the CAE and the CFO virtually never stops; there is interaction before the fieldwork starts, when on assignment, and when back in the headquarters; and all IA findings are discussed

[10] More comprehensive interview data is provided in appendix D. All source data can be tracked by the respective line in the primary document as captured in the hermeneutic unit of the data analysis tool.

regularly and intensively with the owner of the company. In addition, the CAE agrees on an action plan with all key stakeholders to address the findings in a concerted and commonly understood fashion.

The regular coordination with the seventy-seven-year old private owner is particularly telling. The owner insists on receiving the full IA reports in English, rather than only translated excerpts. Frequent review meetings with the owner, who then goes through the IA reports, take place bi-monthly with the CFO and the managing director of sales present as standard members, as well as others as deemed necessary, including the managing director of production if there were audits in that field. The CFO stated, "We work problem-oriented. We agree on actions, that he [the managing director of sales] then implements in his organization, and I implement in mine". Before expanding the audience of such meetings beyond the original core review team of the owner, the CFO and the CAE, the reviews were *"closed shops"* which make little sense when progress is the goal. Consequently, after enlarging the review team, these meetings have become more effective. This case presents strong evidence of how communication can positively affect IA effectiveness when SM and the owner really want IA and when SM and the owner the dialogue (or the role episodes in RT's terminology) as helpful and beneficial.

Goals and knowledge are shared, and mutual respect is displayed. The CAE is proud that the value of the IAF is recognized in the company, the opinion of internal auditors is heard, suggested measures are implemented, and there is now a true IA team, as *"we speak about us rather than about me."* Therefore, knowledge sharing is also an intra-IAF matter.

A main customer of IA is the local management that is audited, as their buy-in is indispensable in improving and resolving what needs to be addressed. This view is clear in the comment that "we in the headquarters in Germany cannot optimize a logistics process in Taiwan, even with an IA report in hand."

Customer feedback regularly obtained from the auditee, and sent directly to the CFO, but in the case of a bad rating of an IA service rendered, the auditee, the CAE, and the owner meet to resolve the issues. In case A there is no *pro forma* capturing of customer satisfaction survey data, but when there is tension, the involved parties get together to address and resolve the matter in the best interest of the organization. By doing so, they

prevent of what may be a small issue from becoming a big problem with potentially detrimental consequences. Timely communication pays its dividend in that way.

The CAE employs guest auditors when auditing a production site (e.g. when a plant manager co-audited a manufacturing site in China), thereby closing an identified skill gap of the IA team. This practice is mutually beneficial for all parties involved, as everyone learns from each other. The quality of the IA work is increased, as is the acceptance of its outcome, and the operational expert benefits and enjoys job enrichment. The company also publishes IA issues and learning on the intranet without "naming and shaming", so all can benefit from lessons learned.

Mutual respect is particularly evident when the SM stressed the perceived value of IA's being able to cross departmental silos, "where the grass of the meadow may be high", thereby improving critical processes. The CFO described the frequent and intense meetings with the owner "sincere esteem for the CAE by the owner."

The company has investigated whether a certain period of service in IA should become mandatory for all future senior leaders before they are promoted to the level of divisional director or business unit manager, where there are about thirty-five positions. The owner has already recognized the possibility of pursuing this approach.

Summing up, case A displays a series of characteristics that indicate a high degree of IA effectiveness. The conceptual framework and terminology Gittell (2006) provides is helpful when analyzing the case, and all but lets the data speak for itself.

The CAE in *case D* benefits from clear and aligned expectations from the CEO.

The communication between the CAE and the CEO as a key stakeholder happens frequently and timely and focuses on problem solving.

This CAE, who has one other staff member in his IAF, has many interactions with the CEO, who also acts as CFO, that increase his comfort with the role and IA effectiveness. This communication is a particular asset in this case, as both individuals have been with the company for over twenty-five years and have come to know and appreciate each other over time. As a result, there is constant informal contact between the CAE and the CEO.

In addition, regular formal management presentations take place about four times per

year, and the CAE updates the risk register and risk report quarterly after consultation with the heads of departments. The CAE also conducts compliance training including training in fraud, bribery, and money laundering. Remedial actions are undertaken promptly and as deemed necessary. As the CEO explains, *"If we come across shortcomings or deficiencies we act swiftly and decisively."*

The CAE formally reports annually to the finance and audit committee of the supervisory board, which is headed by a non-executive director (banker), with whom there is no further contact, formally or informally beyond that interaction.

Goals and knowledge are shared, and mutual respect is displayed.

According to the CEO, the CAE is highly accepted and much appreciated, as he provides management and the board/audit committee assurance that internal controls are working, risks are identified in a timely way, and compliance is maintained. The CEO regards the IAF as a highly specialized function. He discloses a set of criteria and a picture of what he believes an effective IAF to look like; "The successful CAE needs to develop a network within the firm, a high degree of diplomacy is also regarded a crucial skill, and intuition is needed when dealing with different people on different levels in the organization."

The CAE is given the clear business purpose of providing assurance that internal control processes are working, that risks are identified in a timely way, and that compliance needs are adequately understood, respected, and followed throughout the organization.

The CEO wants the CAE to have no fear or favor and says, "the successful CAE needs to maintain his independence, needs to work as objectively as possible and remain neutral, and must be able call a spade a spade." He frames his role expectations by adding that IA will not be successful if it acts too aggressively ("axing", as the CEO put it) and points out, "A young, aggressive internal auditor who gets his teeth into something he cannot release may be quickly burned."

The CEO also indicates, "The CAE should not become the confidante of the management he is reviewing either and should not become a consultant like the controller is." The CEO elaborates this requirement using the example of a budget presentation by management that is defended by the associated controller, as the controller was involved in creating the budget.

The CEO's clear framing of the role of the CAE is helpful as congruency of expectations between the two results that is attributable to many interactions (or role episodes, using RT's terminology) over the years. The CEO expresses clear expectations that are aligned with the CAE's view.

The CAE in *case F* benefits from strong support by the CFO and is entrusted with leading a governance improvement program.

The communication between this *"one man band"* CAE and key stakeholders happens frequently and timely and focuses on problem-solving.

The CAE has frequent interactions with SM and, thus, many moments of truth which were especially helpful when the CAE took on the role after many years as country CFO in a major foreign subsidiary of the firm. The CFO meets regularly with the CAE to coordinate the IA work program and all projects. The CFO views his support and leadership to the CAE as important to the CAE's ability to be successful.

The CAE personally presents all key findings of his internal audit work to the management board. When doing so, he is exposed to the critics in that audience, but those moments of truth make the contribution of IA discernible or, as the CFO put it, *"that provides the major visibility that is needed for IA to be effective. IA must have a distinct value and importance, especially on the management board level, for the top management. Otherwise, it does not have the impact that it potentially can have."* Having regular attention of the management board underpins the added value the IAF is rendering, its contribution, and its importance.

To make an impression and to succeed when meeting and interacting face-to-face with the so-called C-suite, the top management level, and seeking to obtain their buy-in and support, it is critical that the CAE's presentation keep in mind that that audience is typically very busy, demanding, and highly critical. The CAE must be able to convince them of the significance of the findings, as only then will he get their support. Solving problems is what matters most; as the CFO stresses, *"good IA is judged by what is being done, not by what is being written."*

Goals and knowledge are shared, and mutual respect is displayed.

The CAE benefits from the strong support (and coaching) of the CFO, who claims to have a clear concept of what he expects from IA. He views the CAE as business-savvy, which is paramount to him and the entire management board, enabling the CAE to judge trade-offs reasonably, such as those between the effectiveness and the efficiency of controls. The CFO views the CAE as competent and as knowing all critical business processes, and, thus, as being instrumental in the business. As the CFO says, "We improve our processes based on recommendations by IA bit by bit."

The seriousness and speed at which SM reacts to the issues IA flags signal respect. When the CAE reviewed a foreign subsidiary that had recently been added to the group, there were many significant findings. Immediately upon release of the IA report, the CEO demanded that local management address the matters in a timely and complete way, re-enforcing the importance and urgency of the findings and recommendations in the IA report. Follow-up was put on the agenda of the next management board meeting.

The CAE has also been entrusted to initiate a corporate project intended to strengthen the corporate governance system of the company. The CFO expresses his appreciation, saying, "This is a clear sign of the high trust we have in him."

Case F demonstrates that frequent interaction between the CAE and SM, especially when accompanied by strong support from a member of the C-suite - in this case, the CFO – can minimize and possibly even close the expectation gap referenced by Ernst & Young (2006, 30). However, that requires frequent, timely, and problem-solving communication, which is perceived as beneficial for SM as well. That hurdle can be cleared by the CAE, provided SM is at all interested in IA work. The more interaction there is, the more moments of truth there are, and the higher the chances of success, as there are more opportunities to learn and adjust.

The CAE in *case G* personally presents all IA work to SM, making management feel safe.

The communication between the CAE and key stakeholders happens frequently, is timely, and is focused on problem-solving.

The CFO appreciates that stimuli constantly emerge and sees the particular "beauty" of IA in the constant interaction, that is, dialogue. Management is continuously engaged with

IA, and provides pointers when preparing IA for an assignment. The CAE is responsible for IA and risk management. When building the IA plan, the CAE benefits from many pointers and audit requests from members of the organization.

The management board receives all IA reports, which are presented personally by the CAE regularly and in a timely manner after completion. Great emphasis is put on ensuring that IA reports are concise and clear. Brevity and clarity are instrumental when the CAE meets with the management board, and reports should focus on *"what the issue is, where we are, and what shall be done."* The ability to present in this way is regarded as important. The CFO appreciates when there are plans in the report concerning how to resolve the findings, and that the plans are actually being pursued.

In addition, the CAE presents the major findings and status of remedial actions annually to the supervisory board. A summary of risk-management-related matters is presented bi-annually to the supervisory board.

Goals and knowledge are shared, and mutual respect is displayed.

SM regards IA as tremendously helpful in strengthening governance and ensuring that processes work as designed. IA provides a sense of comfort, especially when there are leadership changes; as the CFO puts it, *"IA provides the feel-good factor when reviewing matters independently and giving reassurance that things are in good order."* Thus, SM feels that, when IA points to a problem, the facts presented are supported. It is equally important that, SM perceives that IA has found all that could have been found and that nothing of significance has been overlooked. This view accords with Dittenhofer (2001, 450), who suggests that the measurement criteria to judge IA effectiveness ask, "Did the internal auditor's work result in the correction of deficiencies, if deficiencies existed, or if they did not exist, did the internal auditor's work confirm this condition?"

Internal auditors are viewed as being well informed through audit work but also through their network. The IAF is reported to be successful in attracting talent to work in the IAF as trainees or to join the IAF from foreign subsidiaries. IA staff members who choose to move on in their careers but remain in the organization typically find interesting and career-advancing new roles.

The CAE in *case H* helps SM and the supervisory board to discharge their oversight

responsibility.

The communication between the CAE and key stakeholders happens frequently, is timely, and focuses on problem-solving.

The CAE is part of the top fifty employees in a huge organization, a status that helps him, for example, when he needs time to meet with the management board members, *"which is not at all a problem."* The CAE regularly meets individually with all members of the management board, typically once per month. He also personally presents major results of IA work and findings quarterly to the management board and presents bi-annually to the audit committee.

The interviewees referred to a number of practical situations in which the IAF was instrumental in solving a problem. These include the discovery and closing of loopholes in IT access-control security and the timely unearthing of breaches of liability that *"can cause danger to life and limb"* in the business before any damage is done.

Goals and knowledge are shared, and mutual respect is displayed.

The predominant concern that SM and the advisory board expect the CAE to address is discharging their legally required oversight responsibility. Consequently, the IA mandate is dominated by the motivation to support the management board and the supervisory board in discharging their governance duties. Therefore, the IA approach tends to be quite formal; in fact, according to the CAE, there is no informal contact with the audit committee at all.

The CFO views IA as a business partner. To underpin his appreciation of IA as *"part of the system of checks and balances,"* the CFO stated, *"if there were no IA someone ought to invent it."* The CFO's appreciation is fueled by his view of IA as capable of investigating deficits in processes and suggesting improvements, such as in an infrastructure project in which the investment required was repeatedly increased, and IA was called in to perform an *ad-hoc* review. IA revealed that a number of guidelines had been disregarded, and the matter was rectified.

The CFO points to a moment of truth when he distinguishes the good from the not-so-good internal auditor. The closing meeting in which IA work and results are discussed

helps him to sort the wheat from the chaff. It is there that the CFO can see whether the internal auditor can argue conclusively, how clearly questions are answered, whether some questions may not be explicitly covered in the IA report, and how accurately (or inaccurately) the internal auditor assesses the auditee individually and as a team. In the CFO's view, "in a report, you can cover up [inadequacies] with a lot of time and coordination effort, but that is a great deal more difficult in a discussion."

Cross analysis, top half

Whilst the five cases clustered in the top half are all different, there is a common pattern in that interaction with the chief stakeholder happens regularly and frequently, in a timely manner, and that the communication is geared toward problem solving. With many moments of truth, the chances are heightened that expectation gaps can be narrowed or even closed, to the extent that there is, in the German governance context, congruency of expectations between the service provider – that is the IAF, led by its CAE - and the prime service beneficiary, SM.

The communication protocol and the pattern that is displayed by the IAFs in the top half are expected to induce a reinforcing *positive* spiral that is instrumental in achieving and maintaining a comparatively high level of IA effectiveness. It appears to be good practice that reports are issued and distributed to a defined audience, including SM, and that the CAE personally presents the key results and recommendations of IA work to SM. The seriousness and speed with which SM chooses to act or not to act subsequent to IA's making them aware of critical issues signals different degrees of intensity of IA effectiveness. In addition, goals and knowledge are typically shared, and mutual respect is displayed.

The CAE in case A thrives on the owner's sincere interest in the work of IA. The CAE in case D benefits from clear expectations by the CEO. The CAE in case F benefits from strong support by the CFO and is entrusted with initiating a governance improvement program. The CAE in case G makes management feel safe, and in case G, the CAE helps SM and the supervisory board to discharge their oversight responsibility.

We now consider the bottom half of cases. A snapshot of the source data supporting RQ3 is provided in table 4:

Table 4: Interpersonal factors, bottom group (cases B, C and E)

Case	Key point	Key quote
B	In case B, the CAE has limited interaction with key stakeholders and the IA plan is not risk-based.	The CFO wants IA to be conflict-free, as "it would not be a good sign if [the CFO] received frequent complaints from the markets the CAE is visiting."
C	The CAE of case C heads a comparatively empty shell.	Seeking to explain why the IAF he is heading is in such bad shape, the CAE points to SM, stating, "About every two years, we get a new boss. That is another reason why the IAF has not been staffed better. By the time, that person has dealt with IA matters, he is already on the way out - not necessarily out of this organization but on the way to passing the function on to someone else."
E	The CAE of case E views his assignment as last stop before retirement.	The CAE himself is uncertain, "whether there is anyone that would miss the controls and audits we do."

4.3.2 Relational coordination, bottom half

The cases B, C and E are clustered into the bottom half and are viewed as samples that arguably represent relatively less effective IAFs.

In *case B*, the CAE has limited interaction with key stakeholders and the IA plan is not risk-based.

The communication between the CAE and key stakeholders is either very limited or only on an "as needed" basis.

The CAE has very little contact with the CEO, the CAE's direct boss, as communication occurs only on an as-needed basis. The CFO wants IA to be conflict-free, as *"it would not be a good sign if [the CFO] received frequent complaints from the markets the CAE is visiting."* This view may conflict with the expectation that internal auditors should be able to report without fear or favor.

On paper, the CAE has a reporting line to the audit committee, but that reporting is all but practically void. Apart from presenting the IA plan to the audit committee once a year, there is neither formal nor informal interaction between the CAE and that oversight body. When the IA report is presented only one major finding is listed per IA report and the IA plan for the coming calendar year is shown. There is very limited two-way communication.

Goals tend to be functional only, knowledge remains exclusive, and disrespect is

displayed, especially as there are negative preconceptions that include elements of "finger-pointing".

As the CAE admits, *"The IA plan is not based on a risk assessment"* but is determined top down. Therefore, all subsidiaries are subject to review every other year, regardless of their size or significance. There is a separate risk management department, but IA does not refer to what risk management is doing or build on that. The two organizations are essentially parallel.

When the CAE classifies an IA report as one of deficiency, the organization is rated as *"in general working well with the following exceptions."* That type of hazy coding disguises the actual meaning, which may confuse stakeholders and water down the impact the IAF could have.

The CAE also seems to have a preconceived concept of his audit universe. For example, he concludes, "if the managing director has a marketing background and if that person has also a relatively weak administration manager, it is safe to assume that you find a lot there."

The CAE explains his limited contact with the CEO by stating, *"In our industry and given their typical background as pharmacists or medical doctors, as a rule, they do not care two figs about internal audit."* He continues that he occasionally had the feeling that some recipients of IA reports had a *"tabloid press reader style" ("Bildzeitungs-Leser-Stil") –* that suggests a certain degree of disrespect and "finger-pointing" as far as his customer and stakeholders are concerned and that ultimately does not reflect well on the CAE.

The CAE of *case C* heads a comparatively empty shell.

The communication between the CAE and key stakeholders is infrequent and delayed, if it happens at all.

The CAE reports that there are only some conversations with the deputy-CEO, to whom he reports. According to the CAE there are only very rough expectations of what IA should do, and *"sometimes I wish that expectations from management were more specified so I could be in the position to act more purposefully. Nevertheless, that is rarely the case."* Therefore, very little input is provided and expectations are not clear.

This example is beyond the scope of RT (Kahn *et al.* 1964, 27), as that theoretical framework generally assumes that expectations are communicated. The complementary and additional explanatory power of RC (Gittell 2006) is helpful.

There is no interaction with other members of the management board. There was a moment of truth, a watershed event, that represents a particular role episode (Kahn *et al.* 1964) and that explains the genesis of that perpetual status. Some years back, there was a clash when the CAE was about to form a risk-based IA plan and wanted to including pointers from SM in the IA plan. That process escalated at a time the management board had reallocated responsibilities, and all members of the top management team pointed to their newly added areas of responsibility in order to reduce their uncertainty, the CAE assumes, but also to document how bad things were when they took over. The CAE suspects that that practice was motivated by the desire to obtain *"some sort of a free ticket one to two years down the road that they had acted quickly after assuming responsibility of a business in dire straits."* Since then, all communication for input to a risk-based IA plan has been exclusively channeled through the deputy-CEO.

Goals are functional only, knowledge remains exclusive, and some degree of disrespect is displayed that contains an element of "finger-pointing".

The CAE states that he is under a level of psychological strain that he views as *"still acceptable."* He is fully aware that he is leading a subpar IAF. He regrets that *"the audit cycle is beyond good and evil"* and that the cycle stands at anywhere between five and ten years; that is, *"if we audited a business unit today, it may well be that we will not be back until after 2020."* Clearly, IA resources are scarce; they were even absent in the first half of 2010 when additional capacity was required to handle the customs and foreign trade assignments.

Seeking to explain why the IAF he is heading is in such bad shape, the CAE points to SM, stating, *"About every two years, we get a new boss. That is another reason why the IAF has not been staffed better. By the time, that person has dealt with IA matters, he is already on the way out - not necessarily out of this organization but on the way to passing the function on to someone else."*

The deputy-CEO acknowledges that the function is understaffed, although adding more resources is currently not considered an option. While he is fully aware of the staffing

constraints and the poor audit coverage, he is still *"pleased with the work rendered by internal audit based on the available resources."* That assessment must not necessarily be regarded as cynical but as a reflection of his and SM's low expectations of IA in this organization.

The deputy-CEO states, *"We have allocated priorities in the top management team, and everybody is very busy and has his things."* This view points to functional goals and exclusive knowledge. With different functions having different goals, the priority for IA seems particularly low. The deputy-CEO explains some cut-backs for IA when requesting IT support as an issue of resource constraints and competing priorities: *"Yes, we have problems, and certain people say, 'Sorry, not now.' Currently we must push an important IT project that demands all the IT capacity we have."* Therefore, IA seems to be at the very end of the food chain. Having a seat at the table - which internal auditors and its representing professional body, the IIA, advocate - enhances the contribution that IA can bring to an organization but the CAE in case C has no such seat.

Summing up *case C*, according to the CAE, the CEO, who is also the owner of the company, views IA as an administrative function. In short, the CAE *"has had the impression for long time that we are only a fig-leaf"* or, as" Davies (2009, 61) puts it - *"Cinderella function."*

The CAE of *case E* views his assignment as last stop before retirement.

The communication between the CAE and key stakeholders is limited.

The CAE reports officially to the CEO, and *de facto* to the CFO, who gives some guidance when IA work is planned, and reviews draft reports before they are released. The CAE presents annually to the finance committee, but there is typically no discussion at all. Little, if anything, appears to be scrutinized. The CAE has not issued any deficient-rated report since joining the company about a year ago. His temporary contract expires in two years, and he hopes to get an extension of another three years and to qualify for retirement thereafter.

Goals are functional only, knowledge remains exclusive, and some degree of disrespect is noted in a quote by the CFO.

The CAE himself is uncertain, *"whether there is anyone that would miss the controls and audits we do."* The CEO explains that it is company policy to offer only temporary contracts, which he admits may compromise quality when hiring internal auditors. If there is a poor performer, there is typically no discussion or dispute about the work they do, and they say to themselves, *"What of it?"* since his or her contract will simply expire and will not be renewed. When commenting on a working group of internal auditors that the CFO was chairing, he noted, *"It was inevitable that there were some that resembled cartoons of nitpicker."* This comment reveals to some degree how the CFO perceives the contributions from internal auditors.

Case E has a tame IAF that does not raise any dust, as there has been no deficiently-rated report since the arrival of the CAE, who has little ambition and views his engagement as a last stop before retiring. His options seem to be limited.

Cross analysis, bottom half

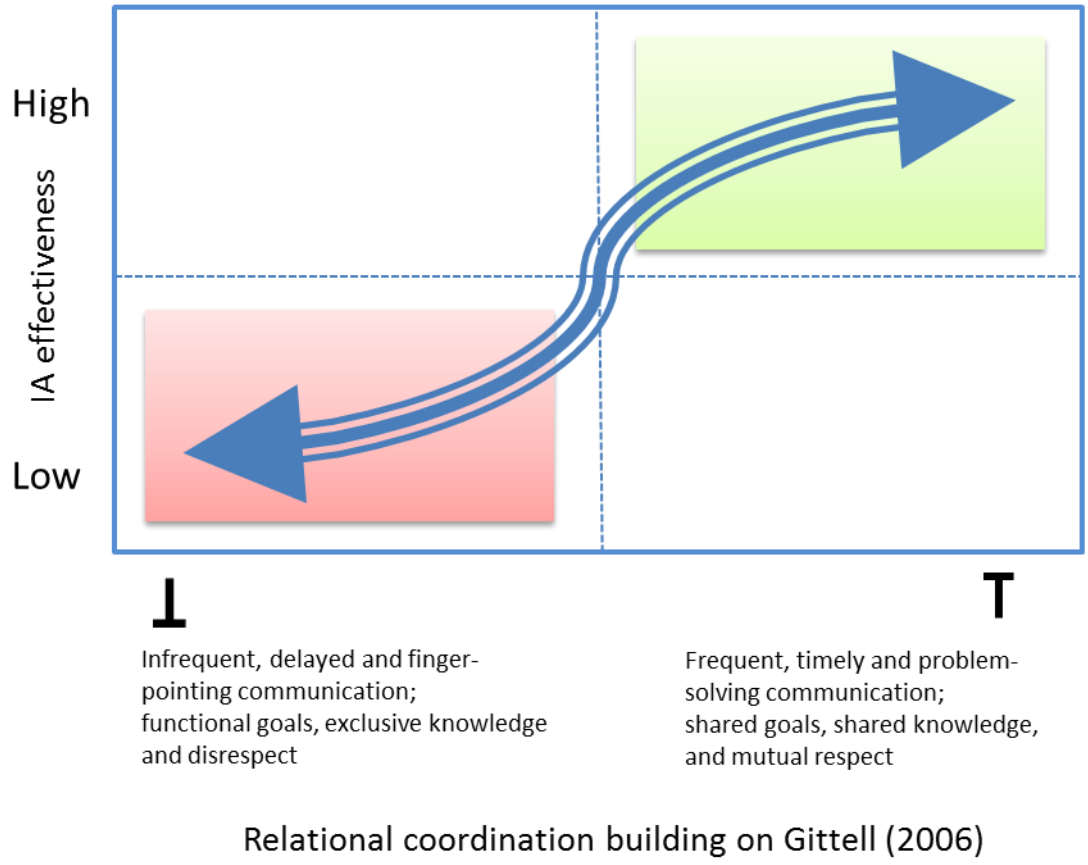
While the three cases that are clustered into the bottom half are all different, there is a common pattern in that interaction with the chief stakeholder happens infrequently and is often delayed and, that the focus on problem-solving being much less evident than typically seen in the cases clustered in the top half. In case B, the CAE enjoys limited interaction with key stakeholders, and his IAF falls short of the basics of IA, as exemplified by its not applying an IA plan that is risk-based. Case C represents an IAF that is something of an empty shell, a façade. In case E, the CAE works on a temporary contract only and views his assignment as last stop before retiring.

With many fewer moments of truth in the bottom half of the cases, the chances are much lower that existing expectation gaps between SM and the CAE can be narrowed. On the contrary, communication patterns make it likely that gaps will widen to the point at which communication may even come to a complete stop, separating the worlds of CAE and SM. In those cases, there is either relatively little congruency of expectations or, SM does not really want the IAF to do what it is supposed to be doing based on its professional standards (IIARF 2011a), and the CAE accepts that situation. Thus, the communication protocol and pattern that is displayed by IAFs clustered in the bottom half may induce a self-reinforcing *negative* spiral that results in a comparatively low level of IA effectiveness.

Cross analysis, top versus bottom half

Contrasting directly *case A* against *case C*, as the most revealing cases in both groups, and similar to Gittell's (2006) case study on SWA and AMR, makes clear that IA effectiveness is a function of the degree of relational coordination, as illustrated in figure 4.[11]

Figure 4: The pattern of interaction is a key determinant



[11] The symbols "T" and "reverse T" shall represent the end points of two extremes, successful coordination and teamwork on the one side, and unsuccessful coordination and lack of teamwork on the other.

The pattern of interaction is a key determinant of IA effectiveness. Interpersonal relationships matter. The mechanism seems to work both ways. There can be successful coordination and teamwork, as Gittell (2006) described in the SWA case. The CAE can be empowered and perform as in *case A*, where there is permanent dialogue between the CAE and SM (CFO) and, in that case, also between the CAE and the owner. Coordination and teamwork can also be absent, Gittell (2006) described in the AMR case. The CAE may be intimidated and may choose to retrench. The CAE in *case C* is resigned to the situation and the contempt expressed by SM. In case C, it seems there is no serious dialogue at all.

Therefore, where SM, possibly pushed by the supervisory board or the owner himself (*case A*), truly supports the IAF and wants it to look at the right matters, the effectiveness of the IAF will be fundamentally different from a case where the management and/or board is passive, (*case C*) and does not help/push the IAF to become effective by unearthing matters they may well not actually wish to be found.

All of the companies' SMs seem satisfied with the service rendered by IA, even in *case C*, where the subpar IA service is evident. Thus, the findings demonstrate that meeting expectations from SM, as a criterion for measuring IA effectiveness, can easily be misleading as expectations in practice vary widely, and may not be adequate.

When contrasting directly *case C* against *case D* that comparison theoretically allows further explanation. While the demographic data of these two cases look very similar (same industry and similar size in terms of revenues and staffing) they are quite different in terms of IA effectiveness for the CAE in *case C* is entrenched and may have already resigned in spirit. While this study points to the important influence of the relational dimension between CAE and SM (and the board/AC) there is a sort of "chicken and egg" problem in IA, which questions what we know about the causality of effective IA? The influence of the relational dimension between CAE and SM and the board/AC is viewed as important, but there is no knowledge about the direction of the effect. Successful interpersonal interaction can lead to IA effectiveness. In turn, IA effectiveness may also lead to improved interpersonal relations. In other words if IA is really "good" (strong/effective), then when SM realizes this, the nature of CAE/SM interactions may improve. Likewise, if IA is really "bad" (weak/ineffective), then SM may choose to largely cut-off communication. We do not know to what degree that consideration has

influenced SM's communication pattern in *case C*. Experimental research is encouraged to provide further insights into this "chicken and egg" problem, namely the causalities between the factors that affect IA effectiveness.

Before summarizing key conclusions and suggesting avenues for further research, the limitations of the study are presented.

5. Limitations of the study

Several limitations of the study should be kept in mind when interpreting the results.

First, the sample base may be skewed, that is, it may include disproportionate numbers of relatively strong cases of IAFs, as CAEs who believe managing a relatively effective IAF may have been more inclined to participate in the study program than were those who believe they are managing a relatively ineffective IAF. In addition, all participating CAEs are members of the German Institute of Internal Auditors (DIIR) which may not be representative of the whole population of IAFs in Germany.

Second, while the study seeks to learn from insights into extreme cases, the samples were ultimately included in the study based on their willingness to participate. Maximum variation sampling is hard to achieve in full as for the CAE to get their SM to participate there has to have been a minimum level of cooperation and communication between the SM and the IAF.

Third, the study is limited to the German context, which is characterized by a two-tier board structure. Consequently, wider generalization may not be appropriate, as CAEs in German organizations generally report to SM. The direct and frequent access of the CAE to the supervisory board and audit committee remains an uncommon practice in Germany at this point.

Finally, as expected from every case study researcher, all evidence must be presented fairly. While fair presentation has been attempted in every respect, the impact of judgment when perceiving and interpreting data cannot be ignored.

6. Conclusions and avenues for further research

This study enhances and it makes valuable contributions to the understanding of IA

effectiveness. This study provides an original theoretical framework as we introduce and apply new theories. Combining a classical view, RT (Kahn *et al.* 1964), with a contemporary view, RC (Gittell 2006) is an original theoretical lens and a unique contribution of this research. We have rich interview data addressing IA effectiveness from the perspectives of both the IAF and SM. We interview both the CAE and SM in the same organization which is the particular contribution of this study. This is one of very few studies on IA effectiveness and the first one in the German context, where interviews are conducted with both the CAE and SM in the same organization, and this is where CAEs and SM in the same organization.

The multiple-case study focuses on the CAEs and SM in the German context and shows that there are notable differences among IAFs. With the difference found in practice, especially when assessing the relationship between the IAF and its key stakeholder the relatively *more* effective IAFs were distinguished from the relatively *less* effective IAFs, thereby addressing RQ2 and RQ3. By applying the analysis to exploit role theory (Kahn *et al.* 1964) and the theory of relational coordination (Gittell 2006), it is possible to sort the wheat (more effective IAFs) from the chaff (less effective IAFs).

The study shows that role theory (Kahn *et al.* 1964), formed by the dynamics of organizational factors, personality factors and interpersonal factors as building blocks, provides a promising theoretical framework that is well tailored to the research subject of IA effectiveness, especially when combined with the theory of relational coordination (Gittell 2006), thereby addressing and confirming RQ1. The study shows that organizational factors, personality factors, and interpersonal factors influence IA effectiveness.

The study also shows that the pattern of interaction between CAEs and SM are a key determinant of IA effectiveness. The effectiveness of IA is largely determined by "soft factors", which can be discussed and explained using the especially helpful framework provided by Gittell's theory (2006). Therefore, where SM, possibly pushed by the supervisory board or the owner himself, truly supports the IAF and wants it to look at the right matters, the effectiveness of the IAF will be fundamentally different from cases where the management and/or board is passive, and does not help/push the IAF to become effective by unearthing matters they may well not actually wish to be found.

Additional main conclusions are highlighted below.

The pattern of interaction can enhance or detract from IA effectiveness

Interpersonal factors matter. The pattern of interaction influences the effectiveness of IA at the top end. While the five cases in the top (more effective) half are all different *per se*, there is a common pattern that interaction with the chief stakeholder happens regularly, frequently, and in a timely manner, and furthermore the communication is geared towards problem-solving. With many moments of truth, the chances are heightened that expectation gaps can be narrowed, or closed such that there is congruency of expectations between the service provider - that is, the IAF led by its CAE - and the prime service beneficiary, SM. The communication protocol and pattern displayed by the IAFs in the top half are expected to induce a self-reinforcing *positive* spiral that is instrumental to maintaining a comparatively high level of IA effectiveness.

The pattern of interactions also affects IA *in*effectiveness at the bottom end. With fewer moments of truth, the chances are greatly reduced that existing expectation gaps between SM and the CAE can be narrowed; on the contrary, these communication patterns make it likely that gaps will widen to a point where communication may come to a complete stop, separating the worlds of CAE and SM. In these cases, there is either relatively little congruency of expectations or SM does not really want the IAF to do what it is supposed to do based on its professional standards (IIARF 2011a), and the CAE accepts that situation. Thus, the communication protocol and pattern displayed by the IAFs in the bottom half may induce a self-reinforcing *negative* spiral that is instrumental in maintaining a comparatively low level of IA effectiveness.

Meeting expectations can be a misleading concept

The study confirms that clear expectations from SM are an important enabler of IA effectiveness. At the same time, the study suggests that meeting expectations from SM, as a criterion for measuring IA effectiveness, can easily be misleading, as expectations in practice vary widely, and may actually demand very little of the IAF, as demonstrated in *case C*. The CAE in case C is aware that he heads a subpar IAF, but he seems to be entrenched, and while SM acknowledges the resource constraints it has accepted the consequences of the much lower level of service that the IAF can render.

CAEs typically adjust to expectations, upward and downward

Organizations seem ultimately to have the IA services to which they aspire. The selection process happens over time, as internal auditors who fit the organizational context may join the organization and stay, while those who do not fit may not join in the first place, may adapt, or may move on. In other words, there is tendency towards congruency of expectations. The CAEs typically adjust to expectations, which can work both ways: *Case A* serves as an example in which the value proposition is adjusted upward, as the owners require the CAE to report bi-monthly to discuss IA matters. *Case C* serves as an example in which the value proposition is adjusted downward, as the CAE has become marginalized. He is completely ignored by the CEO and is authorized to discuss IA matters with only one member of the SM team, his direct boss. Moreover, the focus of IAF was shifted away from IA matters to emphasize customs and foreign trade, resulting in the IAF being little more than façade.

CAEs can drive the agenda as well

In some situations in practice, it is not SM's demand-driven expectations but supply-led suggestions from the CAE that lift the IAF onto a higher plateau. Case D, where the CAE suggested expanding the remit of IA to include risk management and compliance, thus addressing heightened demands from legislative changes (BilMoG 2009) and helping SM and the board/audit committee to discharge their responsibilities more effectively demonstrate such a situation. Based on this observation, clear expectations cannot be regarded as a necessary condition; even if absent, the CAE has the opportunity to drive the IA agenda to some extent.

Hidden champions demand and benefit from applying effective IA practices

Organizational factors influence IA effectiveness. *"Hidden champions"* (Simon 2009) demand and benefit from applying effective IA practices. Three of the cases studied belong to that genre of companies, and all three were in the top half of the sample base (cases A, D, and F). This result supports the assumption that organizational factors affect IA effectiveness, as hypothesized when applying role theory (Kahn *et al.* 1964, factor O). The link between organizational factors and IA effectiveness deserves further attention by empirical studies.

Fingerspitzengefühl and swimming in the organization characterize the successful internal auditor

Personality factors influence IA effectiveness. Fingerspitzengefühl is suggested as an umbrella term to characterize what successful internal auditors can do well being skillful when dealing with people, establishing relations, and asking the questions that matter in an intelligent fashion. Professional sociability (professionelle Kontaktfähigkeit) is a key success factor for internal auditors, who must establish new working relationships quickly before moving on to the next assignment. The importance of networking in an organization was emphasized as networking enables internal auditor to be effective. In that context, *"swimming in the organization"* is put forward as a metaphor for an effective internal auditor who represents an effective IAF. The link between personality factors and IA effectiveness deserves further attention by empirical studies. In addition, there might be a separate paper on the use of this metaphor in IA.

Having an IA designation may be over-valued and misinterpreted as a sign of CAE competence

Four out of five CAEs identified as heading more effective IAF have no IA designation (cases A, D, F, and H), an observation that deserves further attention, as academia is not the only place where professional certifications are used to approximate competence (e.g., Krishnamoorthy 2002). The practical benefit may be heightened by reviewing the curricula, securing and possibly increasing the practical usefulness of IIA designations, especially for CAEs. At present, having an IA designation may be over-valued and misinterpreted as a sign of competence. And those who do not have an IA designation may be under-valued and mistakenly interpreted as incompetent.

There are several possible avenues for further research.

- Apply RT (Kahn *et al.* 1964) in combination with RC (Gittell 2006) in a study of the phenomena of IA effectiveness in order to challenge and possibly verify the findings suggested by this research. The possibility of using then once again a German setting exists. In addition, the application of the two theories in other governance environments may be of particular interest.

- Clarify the influence of organizational factors and the associated corporate cultures on IA effectiveness, perhaps by studying *"hidden champions"* (Simon 2009) if access can be obtained, as those firms typically prefer to remain hidden in order to protect their competitive advantage, which may also include their governance and IA practices.

- Clarify the influence of personality factors on IA effectiveness, perhaps by exploiting the metaphors of *"swimming in the organization"* and *"Fingerspitzengefühl".*

- Study the IAF's scope and the concept of a more integrated assurance function, since more effective IAFs often oversee risk management (cases A and G) and sometimes compliance as well (case D).

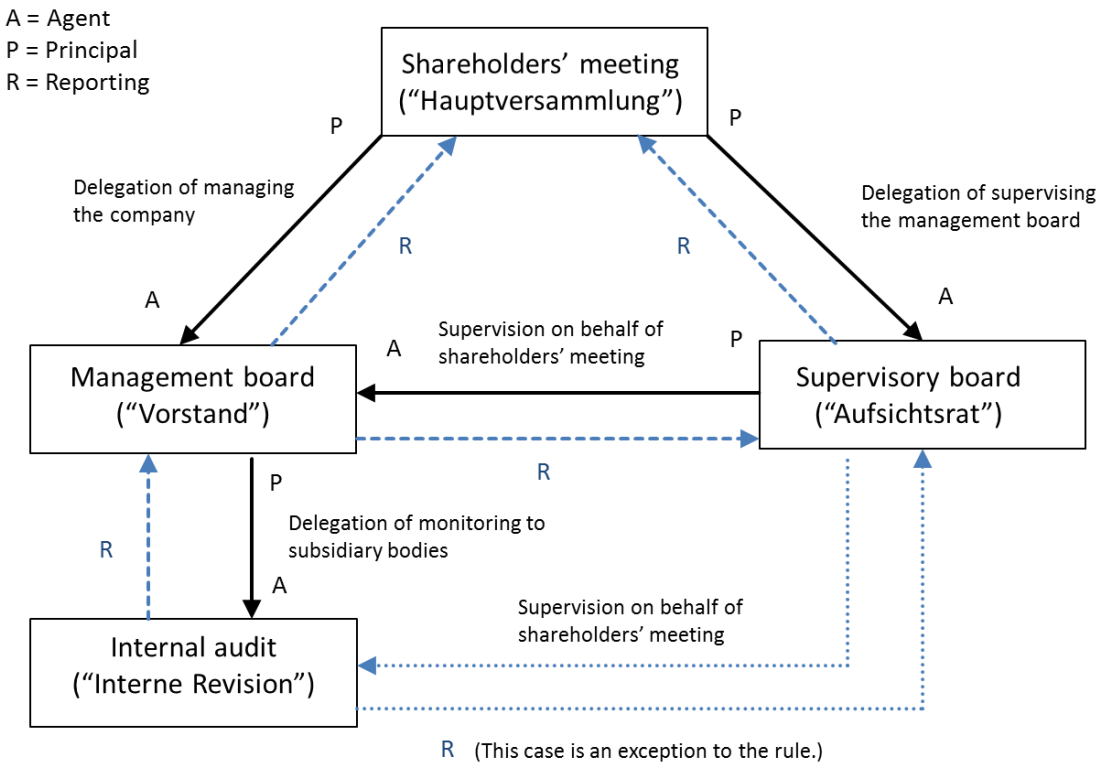
- Study the relevance of IA designations in practice, as there are indications that many effective CAEs do not have such qualifications and many *in*effective CAEs do, thus possibly signaling competence that is not actually there.

- Study the effectiveness of career auditors versus those who stay in the profession only temporary and who have experienced other activities prior to entering the auditing field; there may be some life cycle phenomenon of effective internal auditors yet to be understood.

- How can we resolve the "chicken and egg" problem in IA effectiveness? What do we know about the causality of effective IA? While the influence of the relational dimension between CAE and SM (and the board/AC) is viewed as important, there is limited knowledge about the direction of the effect. Successful interpersonal interaction between the CAE and SM (and the board/AC) can lead to IA effectiveness. In turn however, rendering an IA service that is perceived as effective may also lead to improved interpersonal relations. Experimental research is encouraged to learn more about the causalities between factors that influence IA effectiveness.

Appendix

Appendix A: Relationship between the supervisory board, the management board and internal audit in Germany



Source: Velte (2011, 575), small changes for presentation purposes and own translation

Appendix B: Interview guide Head of Internal Audit (CAE)

1. Internal Audit Function (resource related): How come you are working in internal audit (motivation, career path)? Tell me about you and your team (Experience/s, qualification/s, size)

2. Who is your 'boss'? To whom do you (the CAE) report to? Who has the budgetary control on the IAF?

3. Who has the authority to hire and fire the CAE? (termination rights)

4. Who assesses the performance of the IAF and your (the CAEs) performance? And, on what basis is that done?

5. Processes (good practices): How does on ordinary day looks like? What do you actually do / spend time on?

6. Tell me about what you regard as the most important IA activities?

7. How does good internal audit look like? Would you realize it when you saw / experience it; if so, how

8. Has a quality assessment been performed in the recent years? If yes, what was the outcome? If no, why not?

9. Tell me how the mix/balance between assurance and consulting services is determined in practice; and by whom?

10. Imagine you take on a new role as Head of IAF in another company, so starting fresh, what would you focus on, what is critical to get right?

11. Scoping (goal related): If you explain your internal auditing role to your wife/significant other/kids which picture or story do/would you use when describing

12. Tell me about the goal/s of internal auditing in your company (Tasked doing, aiming at achieving)

13. What is the mission of IA and does everyone perceive this mission in the same way?

14. Tell me how the scope of the IA work plan is build (who contributes and how, annual event, continuous process)

15. Outcomes (result related): Tell me about what you regard as the IAFs key deliverable/service to the company

16. How do you measure your success? (effectiveness, quality of work)

17. What achievement/s as CAE are you most proud of?

18. Whom do you regard as your customer/s?

19. Role of Senior Management: Tell me about your dialogue with Senior Management

20. What do you think Senior Management expect from the IAF?

21. What does Senior Management currently get from the IAF? Is there a gap, a difference between expectation and perceived service rendered?

22. How happy are you with your interaction with Senior Management?

23. Role of the Board: Tell me about your dialogue with the Board

24. What do you think the Board expect from the IAF? (and/or sub-committee like Audit committee)

25. What does the Board currently get from the IAF? Is there a gap, a difference between expectation and perceived service rendered?

26. How happy are you with your interaction with the Board?

27. Role play: If you would be Senior Management (Board) what would you expect Internal Audit to do? What would you do differently than Senior Management (Board)?

28. Future-plans: What are your plans for the future to further exploit the potential of the IAF?

Appendix C: Interview guide Senior Management (SM)

1. Agenda – priorities of Management: Management is busy. Can you tell me about your agenda and priorities
2. SM and IAF – relationship: Which picture or story do you associate with IA /would you use when describing what IAF means to you
3. In which way is Internal Auditing helping you to achieve your objectives?
4. Tell me about your dialogue with the CAE (frequency, formal/informal)
5. To whom does the CAE (Head of Internal Audit) report?
6. Who has the budgetary control of the IAF?
7. Tell me about the goal/s of internal auditing in your company (Tasked doing, aiming at achieving). Why are you having that function? What for?
8. What do you expect from the IAF?
9. What do you currently get from the IAF?
10. Tell me about what you regard as the IAFs key deliverable/service to the company. What is it that you most value?
11. What is it you do NOT get from the IAF that you most miss (do more of/do less of/stop doing/start doing)?
12. What if there was no internal audit function? What would you miss most?
13. Tell me how the scope of the IA work plan is build (who contributes and how, annual event, continuous process)
14. Tell me how the mix/balance between assurance and consulting services is determined in practice; and by whom?
15. Who assesses the CAEs' performance? And, how is it done?
16. Who has the authority to hire and fire the CAE? (termination rights)
17. How do you measure success of the IAF? (effectiveness, quality of work)
18. SM and IAF and Board – relationship: Tell me about your dialogue with the Board on IAF
19. What do you think the Board expects from the IAF?
20. What does the Board currently get from the IAF?
21. What do you think the Board most values from what the IAF is providing?

22. What do you think the Board may be missing the most?

23. Future-plans: What are your plans for the future to further exploit the potential of IAF

Appendix D: Comprehensive interview data

Shared goals, shared knowledge, mutual respect			Frequent, timely and problem-solving communication		
Case A	CAE:	I am proud that we are recognized in the company, that our opinion is heard, that suggested measures are implemented, and that we have managed as a group to speak about 'us' rather than about 'me'. Also, that people simply come and ask. For example, we are invited to contribute to a project of defining a new balanced scorecard. (256); We work with guest auditors, so whenever we audit a production site we include the Head of operations of one of our subsidiaries in Germany (344); He is now three weeks with us in China, then he will go back to his ordinary job. He has enormous pleasure doing this; he fits well in the team. We learn a lot from him, he learns a lot from us. For all involved, this is great (408); We have an advanced human resource department in our company and demanding future leaders to work for a temporary period in internal auditing is being considered (360f.); This idea that future leaders shall work in IA for some months up to one year has already been agreed with the owner (396).	Case A	CAE:	There is regular coordination with the owner. In principle, bi-monthly jour fixe, and more often if needed (80); Last year we realized that such meetings were somewhat 'closed shops' and that this makes little sense if you want to progress. We have therefore decided to also include the managing director of sales as a permanent member of the jour fixe and bring in other managing directors (e.g. production) on an "as needed" basis (84); Customer feedback from auditees is regularly obtained and the questionnaire is sent directly to the CFO. In one case we refer to, the CAE got a bad rating, in response, the auditee, the CAE and the owner met in person to resolve the matter (136); Interaction with the CFO happens regularly, if we are on site, we speak practically daily (336).
Case A	SM:	We produce an annual report of all major findings of IA, and we publish the issues anonymously on the intranet to foster organizational learning (74f); Our staff in IA has a mixed background, one half is financially trained, the other half is somewhat process-trained (146); The main advantage of IA is that it reviews processes that often cross departmental silos, and is thus capable of working at the critical interfaces 'where the grass of the meadow can be high' (154); It is a great sign of respect that the owner of the company, now 77 years old, is meeting frequently with the CAE for hours going through the IA reports in detail (162); The owner insists on receiving the full IA report in English which we then regularly review and discuss jointly, he does not want to receive only a summary version in German as we suggested to him (170).	Case A	SM:	A main customer of IA is the local management that is audited (58); We at the headquarters in Germany cannot optimize a logistics process in Taiwan, even with an IA report in hand. We need to get local management on board to improve and resolve issues (90); My contact with the CAE is intense and frequent. Also, when the CAE is on assignment we regularly speak on the phone (158); When we review the IA reports with the owner, the CAE and my colleague who heads sales, now and again I see things differently than he does, but we work it out in a problem-oriented way. We agree on actions, he then implements them in his organization, I implement them in mine (162).

Shared goals, shared knowledge, mutual respect			Frequent, timely and problem-solving communication		
Case D	CAE:	The IAF combines its genuine IA work, with both risk management and compliance for which it is additionally responsible (20); *'IA is the department you can discuss delicate matters with'* (24); The CAE believes that the perception of the IAF has moved away from company police, towards being more of a business and sparring partner, however, the vast majority regard the IAF as having a control function (24); According to the CAE, good internal auditing requires not only an IA charter, a risk based approach, a high degree of independence, documentation and the following-up of findings, but most importantly *'knowing what makes the company tick'*, the insight into how things are done, informal powers and structures, and the actors to have a personal association with their roles and context (26).	Case D	CAE:	Regular formal management presentations take place about four times per year (12); Additionally, there is regular informal contact with the CEO. Both have been with the company for about 25 years (12); The CAE gives a formal report annually directly to the finance and audit committee of the supervisory board, headed by a Non-Executive Director (banker), with whom there is no further formal or informal contact (12); The IAF updates the risk register and risk report quarterly after consultation with all heads of departments (22); The IAF conducts compliance training including among others, fraud, bribery and money laundering (22).
Case D	SM:	The CEO regards IA as a highly specialized function. To be successful the CAE needs to develop a network within the firm. Moreover, having a high degree of diplomacy is crucial, and intuition is needed when dealing with different people at different levels in the organization (11); The CAE's clear business purpose is providing assurance that internal control processes are working, that risks are identified in a timely manner, and that compliance needs are adequately understood, respected and followed throughout the organization. The IAF renders process accompanying assurance services too, furthermore their consulting services are welcomed but only for those areas where the CAE is truly competent, i.e., internal controls, risk management and compliance (17); In the current set up, the IAF is highly accepted and much appreciated as it provides comfort to management as well as to the board/audit committee, that internal controls are working, risks are identified in a timely manner, and compliance is maintained (23).	Case D	SM:	IA will not be successful when acting too aggressively (*'axing '*), as the CEO put it. *'An eager, young internal auditor risks biting off more than he can chew. He may quickly become undone that way* ' (13); The CAE should not become the confidant of management he is reviewing, either. He should not become a consultant like the controller is. The CEO explains what he means using the example of a budget presentation by management that is defended by the associated controller, which often happens, and which is easily explainable as the controller was involved actually creating the numbers. *'The successful CAE needs to maintain his independence. Needs to work as objectively as possible and remain neutral. And, he must be able call a spade a spade'* (15).

Shared goals, shared knowledge, mutual respect				Frequent, timely and problem-solving communication		
Case F	CAE:	I am integrated into many other functions. For example, last year, having to comply with clear principles, it was regarded important to have standardized management reporting structures that also strengthen our internal controls and I was assigned to lead a project to modernize our controlling system accordingly (19); When on assignment I detected a serious Business Continuity problem. The local General Manager believed a readily accessible, fully effective back-up solution from a remote locations was in place. My analysis convinced him that as a branded manufacturer it is crucial to avoid stock-outs and therefore more was required to secure a minimum functionality to back-up order entry, invoicing and minimal production at an off-site location. Immediate action was then taken by the General Manager. This was a true sense of achievement (95); When contributing last year to define user rights in an organization the CFO and General Manager explicitly commended my part (111); When building the IA plan all Country General Managers and their CFOs as well as the Management board provide input (127); Last year we had an IA in a subsidiary that had newly been added to the group. The findings were many and significant. Upon release of my IA report, the CEO re-enforced its importance and urgency by immediately summoning local management to fully address its recommendations in a timely manner. Furthermore, follow-up was put on the agenda of the forthcoming Management board meeting (179); I am happy with my interaction with the Management board. However, contact with the CEO could be just a little closer, although I realize in his way of dealing with me that he does value me. I reckon there is an heightened esteem (187); If I was the CEO I would not change much as far as IA is concerned. I have great freedom, actually boundless freedom about what I do and how I do it (207).	Case F	CAE:	I put particular emphasis on intensively communicating the results of my audit work. That is typically rewarded when on follow-up it is apparent that 100% of findings have been addressed (31); While still on site, at the end of each audit there is a closing meeting at which I discuss the audit list and recommendations with the entire management team (47); Subsequent the completion of an IA assignment I always present the outcome to the Management board. When doing so I focus on the most important risks, the A-risks (115); When implementing SAP we build-in preventive controls, e.g., if someone that is authorized in purchasing wants to register a new vendor that mandatorily requires another authorized person in Finance to release that transaction. When doing so the virtual signature that authorizes that the new vendor can be registered is archived, also. That way we systematically apply the four-eye principle, and we document what we do (131); With most members of the Management team I have a good rapport, we meet regularly and also informally in the hall as our offices are nearby, and I get appointments with them at short notice. Only with the CEO that is sometimes more difficult. I have a very close relation with my administrative boss, the CFO, and we meet monthly also with his other direct reports from accounting, controlling, treasury and IT (167); I personally have not been in touch with the supervisory board ('Aufsichtsrat') yet (191); If there was no IAF process know-how would be lost. I have often improved and actually stimulated internal communication, also providing benchmarks in the group from subsidiaries that have already worked their way through a problem similar to that now faced by another subsidiary. I can connect the two and point to the solution found in one place which also may prove useful in the other case also. Bi-annually we have a CFO meeting with all subsidiaries, and I think I am some sort of a hinge, a connector, a facilitator of relationships (251).
Case F	SM:	I have two images in mind about IA which are actually the same thing. One has to do with risk which is reflected in the IA plan where we seek to avoid or mitigate the biggest risks. The other is about improvement of business processes. IA knows all critical business processes and can have a high added value for the organization (18); Bit by bit, we improve our processes based on recommendations by IA (22); I have regular meetings with the CAE where we coordinate all projects and internal audits. Every audit and every report is presented to the Management board and also formally concluded there. That provides major visibility. That is needed for IA to be effective. IA must have a distinct value and importance especially at the Management board level, by the top management. Otherwise, it does not have the impact that it potentially can have (30); To me it is always important when IA is business savvy. Then they can get a lot more done, they have more acceptance and are better at judging trade-offs. One can do IA dogmatically, it is about finding the right balance, ultimately between effectiveness and efficiency (38); My support and leadership to the CAE is important for him to be successful (58); The CAE is entrusted with a very important initiative. He is tasked to lead a team that includes two senior lawyers, and in that capacity he reports to the steering committee with the CEO and CFO as members, also involving the entire Management board and the country managers of our subsidiaries. The project is about strengthening our corporate governance system which includes developing and implementing for example, a code of conduct, an anti-corruption policy and diverse guidelines in the sales area. As we are a multinational company, we cannot know what is happening everywhere, so clear rules of the game need to be agreed and compliance must be secured. At some point the CAE will pull out of the process establishing the new principles as that may become in conflict with his role but at the beginning he is engaged in a leading role. This is a clear sign of the high trust we have in him (74); I have a clear concept what I expect from IA. And that is no means in itself or some sort of alibi, but rather it must render added value to the organization (86); I can imagine and I	Case F	SM:	I have regular meetings with the CAE where we coordinate all projects and internal audits. Every audit and every report is presented to the Management board (30); It matters how the internal auditor presents findings and suggestions to the Management board. Care has to be taken, what are the core points that are relevant to the Management board. Apart from this, much depends on the communication, how the internal auditor gets them on their journey. It is important to be responsive the audience, then it works (42); We are working very closely together. I have coached the CAE intensively. Communication, focus, priorities are very important matters (46); Good IA is judged by what is being done not by what is being written. And that depends on whether local Management, where the IA was carried out, and also whether the top Management can be convinced to then actually implement what is recommended, understood and accepted. If there was only a report, and then another report, but no change for the better in practice as far as fundamental matters are concerned, but only some formal things and that's it, then IA did not have the impact acknowledging that the internal auditor does not implement himself (54).

Shared goals, shared knowledge, mutual respect				Frequent, timely and problem-solving communication		
Case G	CAE:	I am responsible for Corporate Audit and Risk Management (7); When we build the IA plan we benefit from an enormous number of pointers and audit requests from members of the organization. Once per year we ask in principle all managers for their perspective and input. The IA plan then stems about 50 per cent from the risk management system and 50 percent from management requests (11); The top performer in IA work very efficiently and gain time that way to improve their quality of work also, they mix well with the auditee and are informed openly that way. If there was no bond of trust there are no pointers. And, many things make sense through such pointers (23); Ultimately, we work for the Management board and we want to inform them all-inclusively about what matters. This is the main thing (33); Management feels certain by now that in case we point to a problem the facts presented hold water. And, there is the perception that there is nothing more of significance, so that all that could have been found was actually found by the internal audit (63); Management is interested in our reports. At the top level and below that. The rapport to auditees is normally good. I think we have a good reputation. We occasionally unearth issues that truly matter, that are taken seriously. We are no organizational lightweight (67); We are well informed through our audit work but also through our network. We are well integrated formally and informally. Also, we have success attracting talent to work in the IAF for some time as trainee or joining us from foreign subsidiaries, and we also see staff that has worked in IA progressing their career well when taking on new roles within the organization (69); The image of IA is largely formed by the way of working with the business units. It is not about being the big consultant, we rather aim at impressing by positive bearing through displaying personal integrity, professional competence, being organized, cooperate well with the business unit and providing a fair and realistic assessment. And we focus on what truly matters. I believe all this is contributes to be perceived as a helpful and value adding support function which is instrumental to attract the right talent, who we can develop further throughout their tenure in IA and who will then eventually move on taking on	Case G	CAE:	I present every IA report to the Management board. It is important also for me when I go there with 10 IA reports and about 30 findings each that I can easily spot what matters. It is thus important when reading each part of the IA report that from the start, it is concise and clear, what is the issue, where are we, and what shall be done. Obtaining nodding approval is the best (49); I am communicating very efficiently. When there is an audit with a good outcome, then there is not much to be said, that may take a few seconds. If the Management board want a discussion more time is taken to go through the issues and recommendations (51); We have defined addresses of IA reports. All ordinary IA reports are sent to all members of the Management board. Additionally, the reports are presented to the Management board by me with SM being typically well prepared. Moreover, bi-annually I make a summary presentation to the finance committee and the supervisory board about risk management, and annually I report to these audiences about IA (55+75); It is common practice that all the content of the final A report is already discussed in full in the closing meeting when still on site. Thus, all issues and actions can be agreed locally. There is consensus about the facts. There has not been any counter statement by the local business units (111).
Case G	SM:	IA is tremendously helpful as it strengthens governance securing that processes work as designed. We use IA when we need comfort especially when there are leadership changes. IA is respected as a service provider rather than as inspector (18); Findings in IA reports are generally agreed with the auditee (38); In case there is something conspicuous we send IA to investigate where action is needed (50); IA helps to improve processes and is an important instrument to secure good practices that are universally applied (54); IA provides the feel-good factor when reviewing matters independently and giving re-assurance that things are in good order (74).		Case G	SM:	Stimuli constantly emerge, the beauty of IA is the interaction, the dialogue, also providing pointers when preparing for an IA assignment (26); IA strives at drawing a reasonable picture avoiding exaggerations (34); There is generally a plan how to resolve the findings in the IA report (38); In case of leadership changes IA typically investigates documenting the baseline, that way also helping to avoid 'finger-pointing' (50).

Shared goals, shared knowledge, mutual respect				Frequent, timely and problem-solving communication		
Case H	CAE:	I am part of the second layer of management, one of the top 50 in our group of about 300,000 employees. I report primarily to the Management board ('Vorstand'), but also to the supervisory board (15); The German Stock Cooperation Act ('Aktiengesetz') prescribes what the Management board needs to accomplish which includes an effective internal control and risk management system and IA is an essential piece of that (75); We review all key processes and seek to provide added-value to the Management board, and the supervisory board also, and help them both with discharging their oversight responsibilities. We may be the one function that has globally the broadest and best insight into the organization (131); We cooperate closely with Corporate Security and Compliance. We work jointly in various committees, we have a clear division of tasks (135); The supervisory board and management need to discharge their responsibilities, if not they have a huge liability problem. To discharge them from their duties is not that easy as there are also other applicable laws to our organization (e.g. the so-called 'Haushaltsgrundsätzegesetz') that we need to comply with which also requires that the IAF is subject to tough scrutiny (171); Management of audited units need to acknowledge the IA report in writing. All findings need to be addressed by the auditee. Extensions of deadlines can be agreed. If there are overdue issues they are escalated to the management board, and if that situation does not improve it can happen that managers get the sack. Whatever happens, the issues have to be implemented (227+231); If I need time to meet any of the management board members that is not at all a problem (237).		Case H	CAE:	We regularly perform customer surveys and it is quickly noted if IA has not met expectations especially as we have audited subsidiaries that have staff of 70,000 to 80,000 people. They are well capable of expressing their viewpoint (79); We use a self-developed IA system that also has the functionality of tracking open IA issues. A summary list with all outstanding issues is reported monthly to the individual member of the management board ('Vorstand'). The status of all reports goes quarterly to the entire Management board. And annually the supervisory board ('Aufsichtsrat') is informed about the status of implementation in a summary report (95); We invest billions of Euros in projects, so we frequently check planning assumptions and measurements and we may identify errors that generate significant cash returns Management then would be delighted about. In the IT area we keep checking security and may point out security gaps so that they can be closed before an external hacker may discover the loophole. When we identify breaches of liability law because some requirements were not met in full we alert Management, as such breaches can cause danger to life and limb in our business Management is most grateful when they are unearthed before any damage was done (147); I meet regularly and at least monthly with the Management board on the jour fixe. I have regular contact with the CEO (237).
Case H	SM:	In an organization of our size processes are generally working. There are though always particular areas where improvement is needed, and in those areas I value the contribution from IA to assess purposefully and suggest improvements, for example, in the area of purchasing, order processing or support functions. IA can be called-in if audit needs are identified also, possibly looking into areas without me or others requesting that, so just based on their own risk assessment to a certain extent they provide independent support and advice (10); IA is a business partner of the CFO. A sparring partner to discuss matters with providing pointers as to where I as CFO should look more carefully (34); Put plainly, if there was no IA it someone ought to invent it. As said earlier, I need someone who has the time and experience to purposefully investigate alleged deficits in processes (42); IA is important to me as part of the system of checks and balances. Having an IAF I am certain that there is an independent function that self-driven, reviews all critical areas and can thereby detect blatant deficits and can if needed escalate the matter right up to the supervisory board ('Aufsichtsrat') to be discussed there (54); Good internal auditors are in high demand in Germany. He/she need to careful not to lose his/her independence, his/her innocence. He/she may not become part of a system that contravenes the rules (58); Organizations are well advised to let IA operate freely. If there was any notion in public that organizations camouflage something or prevents IA from fulfilling its role, those companies would have a huge problem with the public and the capital markets, also (58).		Case H	SM:	To me, a good IA report is analytically concise and providing clear guidance. To illustrate what I mean, there can be a recommendation simply suggesting to revise the purchasing procedure, that would be quite a general advice. I much prefer if the guidance goes further saying e.g. there is a purchasing process that has seven steps, and step three represents the core problem and explaining why that is seen that way and advising on how to improve, also (22); We carried out a particular infrastructure project in which the investment required was repeatedly increased. We asked IA to perform an ad-hoc review to shed light into this. And, indeed, IA unveiled that in practice a number of guidelines had been disregarded (30); To distinguish the good from the not so good internal auditor the closing discussions help to sort the wheat from the chaff. There you can see whether the internal auditor can argue conclusively, how clearly questions are answered, questions about matters that may not be explicitly covered in the IA report, and how accurate or not the internal auditor is capable to assess the auditee individually and as a team. In the report you can cover-up with a lot of time and coordination effort; that is a great deal more difficult in a discussion (66).

Functional goals, exclusive knowledge, disrespect				Infrequent and delayed communication, "finger-pointing"		
Case B	CAE:	I had occasionally the feeling that some addressees of IA reports (which does not apply to my current employer) did have tabloid press reader style ('Bildzeitungs-Leser-Stil') according to the motto that nothing at all serious had been found. I then always replied that there was nothing major, and adding that the internal control system works properly and we did not find any pointers to fraud or alike is an equally important result as if we had found something significant, and that is more delightful, also (59); We have determined that we review the subsidiaries every other year regardless whether they are big or small. I take the line that risk is the outer product of potential damage and likelihood. Naturally, the potential damage is smaller in a small subsidiary when compared to a big subsidiary, however, the likelihood is there higher due to lack of segregation of duties. Thus, to me, when you multiply both the risk in a small firm is as big as the risk in a big firm, to some extent. Risk management I review every three years. The IA plan is not based on a risk assessment (91); We have Risk management. That is well developed. I have audited that two years ago. That is done by the finance department. They cover all major areas of risk and all departments including legal, patents or licenses. That is a terrific technical system (95).		Case B	CAE:	I report annually to the audit committee where I limit my presentation showing just one major finding per IA report that was issued in the past calendar year, otherwise that would be too much as there are 15-16 internal audit reports annually. Also, I present the IA plan for the next calendar year (45); It is often already an insight to know the professional background of the Managing director of the subsidiary to be audited. If that person comes from Marketing and if that person has also a relatively weak administration manager it is safe to assume that you find there a lot. If the Managing director is a person with financial background this is rather less the case. It is a question of knowledge of human nature (71); The smaller the subsidiary the higher the risk since there is no internal control system. We assess that based on knowledge of human nature (99); It is important to me to get more contact with the audit committee or the chair of the audit committee as that is very little the case at present (123); If I was the chair of the audit committee I would invite IA to the quarterly meetings. Especially, as at year-end when reporting about 16-17 audits that already did happen and another 16-17 that are planned in the coming calendar year the agenda is too packed. I would value to meet quarterly (131); Whilst every draft IA report is reviewed by the CFO prior being sent out I have very little contact with the CEO. In our industry and given their typical background being a pharmacist or a medical doctor they as a rule 'do not care two figs about internal audit' (211); Although I am always requested to only present for five to 10 minutes to the audit committee, this takes most often actually twice as much time (247).
Case B	SM:	IA reviews the Risk Management system every three years. IA is not generally tasked to review the credit exposure in the countries it is visiting; that is expected to be dealt with by the respective corporate functions and by local management (18); When assessing the performance of the CAE soft criteria like social competence are regarded to be of paramount importance, *'the CAE must be able to adjust to the people being interviewed'* , as *'it would not be a good sign when I [the CFO] would be receiving frequent complaints from the markets the CAE is visiting'* (24).		Case B	SM:	The CAE has on paper a reporting line to the AC, which is practically not used. Apart from presenting the IA plan to the AC once a year, there is no additional, neither formal nor informal interaction between the CAE and the AC (16).

Functional goals, exclusive knowledge, disrespect				Infrequent and delayed communication, "finger-pointing"		
Case C	CAE:	A good IAF is involved in what is going on in the company and may also be contacted for advice. We must come back to that level as we have been focusing on customs and foreign trade assignments in the past 2-3 years (121); The psychological strain is still acceptable. It would require a continuous improvement process. It is not such that we are suffering so much that we can no longer bear the situation (195); The CEO (and owner of the company) views IA as an administrative thing when speaking bluntly (207); I have had the impression for long time that we are only a fig-leaf but there seems to be change for the last 18 months to two years. There were intentions to further expand the IAF. But then that was deferred because of the financial crisis. Further aggravating is the fact that more and more resources are required to handle our customs and foreign trade assignments which is partly beyond our control especially in the first half of 2010 we had zero resources in internal audit as there were two external examinations in parallel by the customs authority. They had to be fed somehow with information (378); At the moment, our audit cycle is beyond good and evil (406).		Case C	CAE:	There are some conversations with the Deputy-CEO, nothing beyond that. I must add, this had not always been that way. In former times I have contacted top management seeking to understand their perspective and obtaining their pointers and input to the IA plan in the coming calendar year. That process escalated at some point when the management board had re-allocated responsibilities. The suggestions made at that time by all members of the top management team pointed to the newly added areas of responsibility in order to reduce their uncertainty on the one hand but also to document how bad things were at the time they were taking over. With some sort of a free ticket they may have claimed 1-2 years down the road that little they could have done so quickly after assuming responsibility for a business in dire straits (89); With the Deputy-CEO we have annual review meetings and we meet every 2-3 weeks where we get some sort of feedback on how he views the results of the internal audits (280); Sometimes I would desire that expectations from management are more specified in order to be in the position to act more purposefully. Nevertheless that is rarely the case. The concept is rather that we shall take a look at this (284); We could contribute more to internal know-how transfer when we could raise the frequency of internal audits, thereby shortening the cycle of visits. At the moment we stand anywhere between about five and 10 years (370); If we would audit a business unit today it may well be that we will come back there after 2020 next time (374); About every two years we got a new boss, that is another reason why the IAF has not been staffed better. When that person has dealt with IA matters he was already on the move out, not necessarily out of this organization but passing on the function to someone else (386).
Case C	SM:	I have taken over oversight responsibility of IA about five years ago. The IAF has a bad legacy. It has the image that IA comes after the damage was done when someone had stolen something or so. We are trying to bring forward the support role of IA, simplify processes and tell people that they do not need to be afraid, but rather that IA aims at making your work easier serving the organizational objectives (32); We are understaffed, and we know that. The cycle at which we perform internal audits is too big. There is no rhythm and especially in Asia for instance, e.g. China, we ought to be more often. We need to build up resources gradually. We cannot say that we actually need six people, we need to build first the know-how of the organization (48); We have allocated priorities in the top management team, everybody is very busy, has his things. And we want with that filter that all information feeding into the risk assessment process is channeled through me. Of course, I integrate my peers. Every four weeks we meet where that subject can be discussed (52); We have an advisory board ('Beirat'). There is a report in IA where we say what IA has worked on, what the plan is, and particularities - if any. As far as I know that report does not go to the advisory board. The report is sent to the CEO (and owner) and Management board (116+120).		Case C	SM:	To make a visit by IA to a business unit and tell how things shall work, go back home and return then again three years later that does not serve any purpose (80); We have those little kingdoms and they are quite autarchic. You achieve nothing with a 500 page long guidance, what works here is to evidence the practical benefit at a pilot site. Then multiply that. That is how this organization normally works (84); I meet every two weeks with all the departments I am in charge of. There is an agenda. Yes we have problems, partially, certain people say, 'sorry, not now'. Currently we must push e.g. an important IT project demanding all the IT capacity we have (108).

Functional goals, exclusive knowledge, disrespect				Infrequent and delayed communication, "finger-pointing"		
Case E	CAE:	I am not so sure, whether there is anyone that would miss the controls and audits we do (88); I view the delivery on the IA plan as success of the IAF (99); When we present to the finance committee as a general rule there is no discussion at all. Little if anything is scrutinized (167).		Case E	CAE:	I report once a year to the finance committee about the work we do and our audit results. Once a year I also present the IA plan for the coming calendar year (140).
Case E	SM:	As we only offer temporary contracts we may have to compromise when hiring internal auditors (19); When chairing the working group of internal auditors I have soon realized that most are likeable, but *'it was inevitable that there were some that resembled cartoons of nitpicker'* (31); In case of poor performers there was no dispute, people only said to themselves: *'but what of it?'* (107).		Case E	SM:	The poor performing internal auditors only view half the story/picture, come unprepared, are wasting people's time and leave the site without clear findings, report writing takes many weeks with multiple attempts to go back to source and clarify issues there may be (99).

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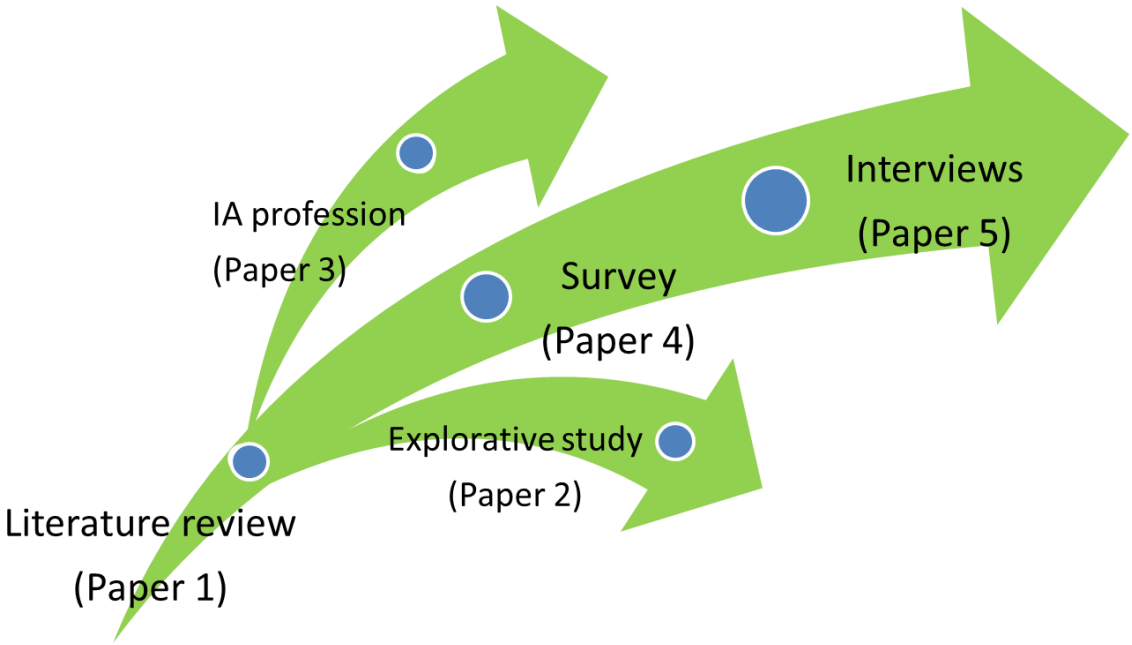
GENERAL CONCLUSIONS

GENERAL CONCLUSIONS

This dissertation opens a little the 'black box' of IA effectiveness by making a significant contribution to the IA literature and the IA community, by providing clear recommendations for practitioners, and by making suggestions to the IIA to improve the IA value proposition. In addition, this dissertation encourages further academic research on the subject of IA and IA effectiveness by suggesting a new agenda of research opportunities with the intent to help bringing out the best in IA.

This dissertation consists of five related papers, which consider a mix of methods and perspectives that lead to innovative and complementary insights providing valuable contributions to the understanding of IA and its effectiveness. The following figure 1 summarizes its structure.

Figure 1: Structure of my dissertation



The figure resembles a flower, with the literature review (paper 1) as the root of my academic work and the multiple-case-study paper based on interviews with both CAEs and SM in the same organization (paper 5) as the blossom.

Paper 1, an exhaustive review of the literature from academics and practitioners literature through an 'effectiveness lens' is the base of this study and from its genesis to its

conclusion reflects the author's learning process in studying the subject matter. Benefitting from the perspectives of new institutional theory and entrepreneurship (DiMaggio and Powell 1983; DiMaggio 1988) as a critical and innovative approach, IA effectiveness is viewed as one way to be perceived as legitimate in the eyes of major stakeholders. By studying the influence of the three isomorphic forces on IA effectiveness, coercive, normative, and mimetic, and exploring situations when these forces diverge and/or are in conflict with organizational demands, paper 1 identifies major patterns in the existing literature and suggests a new field for empirical research.

- In the realm of coercive forces, companies conform to laws to secure their own legitimacy; thus, organizations will have an IAF if it is legally required. However, simply having an IAF says little about its effectiveness. While regulators in some cases demand that firms have an IAF, they seldom specify what they consider effective IA.

- Normative forces also influence IA effectiveness, as compliance with the IIA's standards is demanded. As the identity of IA is not clear, the force is comparatively weak.

- Mimetic isomorphism plays an important role in IA effectiveness. Organizations tend to model themselves after similar types of organizations that are considered successful and legitimate by their surroundings. From this perspective, IA may be considered effective when there is a legitimate, institutionalized model on which to base itself:

    - Open and direct communication between the CAE and SM, as well as regular input to IA planning, a shared perspective on risk based IA and support of IA recommendations are elements of an institutionalized model that could provide legitimacy if an IAF followed it.

    - Access to the board/AC can give the IAF a strong mandate, and it represents a key feature of an institutionalized model that could provide legitimacy if an IAF followed it.

- External audit (EA) typically views IA as auxiliary to EA's tasks. Contributing to the work of EA by in-sourcing parts of EA's activities to save money, represents an institutionalized model for the IAF to mimic in order to gain legitimacy.

When the three isomorphic forces point in different directions and/or are in conflict with organizational demands, the CAE may turn to hypocrisy (Brunsson 1986, 1993) or may become an institutional entrepreneur (DiMaggio 1988; Battilana 2009) to resolve the dilemma. This study provides an agenda for future research on IA effectiveness. The suggested research questions *"What characterizes the comparatively more effective, and value-adding, CAE and IAF?"* are further studied in the following papers.

Paper 2, the explorative study provides variables that are associated with the IAF's role in corporate governance. It is the first paper to examine this research issue. Based on U.S. data, a company with an IAF that has an active role in corporate governance is significantly and positively associated with the use of a risk based audit plan, a quality assurance, and improvement program (QAIP), and AC input to the audit plan. If an IAF wants to increase its contribution to corporate governance, these are important aspects to focus on.

Paper 3, conceptual reflections on the IA profession offer an explanation why the IA profession has been marginalized in the governance debate on solutions to the financial crisis that started in 2007. This paper points to ambiguities and makes suggestions concerning how to clarify and improve the IA value proposition. The analysis suggests that, to become a more relevant stakeholder in the corporate governance arena, the IA profession should clarify its perspective and purpose by determining to whom it is accountable (from whose perspective its added value should be judged) and making its service offering more focused and transparent.

Since rendering assurance and consulting services and positioning IA as both an agent of the board/AC and as a partner for SM is challenging in practice, this paper argues that IA should more clearly bring forward its contributions as an assurance function[1] (rather than as an consulting function) primarily seeking to assist the board/AC in its oversight role,

[1] For example, combined assurance may increase the quality of IA activities and positively influence the overall organizational governance (Sarens, G., Decaux, L. and Lenz, R. 2012).

and also in supporting SM. This paper argues that ideally the board/AC should be the chief stakeholder ('the first boss') of the IAF, while acknowledging the high importance of SM, as it is SM who are more in contact with IA on a day-to-day basis and whose support is needed to ensure that issues raised by IA in their report are remedied and improved in practice. Key attributes of the role of the 'chief stakeholder' would typically include staffing and compensation matters related to the CAE and the IAF who would set the IA agenda and approve the IA plan. This clarification of the IA's unique selling proposition and its chief stakeholder may help the IIA when establishing IA as a full profession.

Paper 4, the empirical survey tests the discriminatory power of IAF characteristics based on survey data from CAEs to cluster different groups of IAF which point to different levels of IA effectiveness, that is, to distinguish comparatively strong (more effective) IAFs from comparatively weak (less effective) IAFs.

The study provides a tool for pointing to different levels of IA effectiveness at both ends of the range as the different characteristics may be associated with highly effective and ineffective IAFs. However, that link between the differentiating characteristics and different levels of IA effectiveness requires further research to validate the results as this study did not include stakeholders in this study design and did not, for example, interview the board/audit committee or SM and capture their perspective whether (in their view) the IAF really helps to achieve the company's objectives.

Acknowledging that caveat, this study plants the seeds for a theory of IA effectiveness. The multi-faceted concept of IA effectiveness that is applied here has four categories of factors, which influence IA effectiveness: (1) organizational factors, (2) IA resources (CAE and internal auditors), (3) IA processes and (4) the pattern of relationships between the CAE and key governance stakeholders. Further research is encouraged to formally test the relationship between the differentiating IAF characteristics and IA effectiveness.

This empirical survey provides access to case studies, which are examined based on interviews with the CAEs and SM of each firm.[2]

[2] When undertaking interviews and discussions for my research, they were conducted with due regard for research ethics.

Paper 5, this qualitative research addresses IA effectiveness from the perspectives of both the IAF and SM based on rich interview data. Sixteen semi-structured interviews of CAEs and members of SM in the same organization were conducted. This study is one of only a few with this type of research design, and this is the first study in the German context for which CAEs and SM in the same organization were interviewed with the purpose of enhancing the body of knowledge on IA effectiveness. This dissertation introduces and applies an innovative theoretical framework to the context of IA that combines the classical view of role theory (Kahn *et al.* 1964) with the contemporary view of the relational theory of coordination (Gittell 2006). The original theoretical lens is an innovative and unique contribution of this research.

The paper shows that customer satisfaction, as a key concept in measuring IA effectiveness, can easily be misleading, as expectations vary significantly in practice, and sometimes very little is demanded. Thus, this finding criticizes the usefulness of 'matching expectations' of SM (which were included in this study) as the criterion of the level of IA effectiveness. Also, this criticizes the underlying definition of IA effectiveness as a 'goal-attainment concept' (definition 1) which neglects that the quality and meaningfulness of goals are of utmost importance.

This study underlines the importance of behavioral dimensions of IA effectiveness. Interpersonal factors can enhance or detract from IA effectiveness: CAEs who interact frequently and in a timely manner with SM using problem-solving communication nurture IA effectiveness, thus, help the organization to achieve its objectives, especially when such communication is supported by shared goals, shared knowledge and mutual respect.

Organizational factors also play an important role, as evidenced by hidden champions[3] who demand and benefit from effective IA practices. The study shows that IA effectiveness is influenced by the overarching organizational effectiveness. Hidden champions can be seen as highly effective organizations that successfully achieve their objectives with limited public attention. IA effectiveness can flourish in that setting. In turn, if there was limited organizational effectiveness, that would harm and cap the IAF's level of effectiveness. IA effectiveness is associated with the overarching effectiveness of the organization in which it is working.

[3] See Simon (2009).

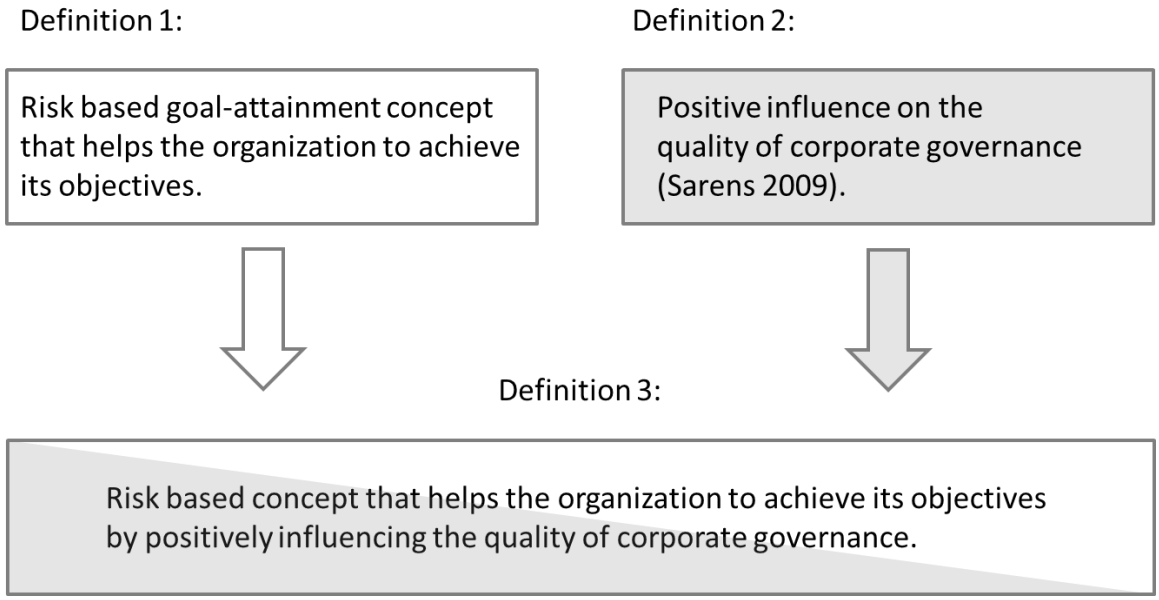
Finally, personality factors affect IA effectiveness. 'Swimming in the organization' and 'Fingerspitzengefühl' are suggested metaphors for effective internal auditors, whereas IA designations for CAEs were not found to add value in practice.

Definition of IA effectiveness

This dissertation provides a definition of 'what is effective IA?' That is challenging, as it is for other so-called "support functions", because the fundamental role of internal auditors is not connected directly to profit and loss (Nobel 2010). In all those cases we lack meaningful quantitative measurement criteria as proxy of effectiveness. Evidencing the effectiveness of EA is also challenging. Moreover, this dissertation provides insights into activities and processes that can enhance or detract from IA effectiveness. This study helps to know a little more what 'good' (that is, comparatively more effective) and 'bad' (that is, comparatively less effective) IA looks like in practice, and it heightens the chances to recognize an effective IAF if you come across one.

This dissertation is built on *two* definitions of IA effectiveness, which are now synthesized into one (Figure 2).

Figure 2: Definition 3 of IA effectiveness



This dissertation defines IA effectiveness (definition 3) as a 'risk based concept that helps the organization to achieve its objectives by positively influencing the quality of corporate governance'. IA is a service to the business. Effective IA reviews the major areas of risk

in order to help organizations achieve their objectives (definition 1). IA contributes to the achievement of objectives by positively influencing corporate governance (definition 2), thereby building on Sarens (2009). The level of 'goal-attainment' for what IA is concerned correlates with the IAF's influence on corporate governance. The suggested definition understands 'governance' as an umbrella term also including risk management and internal control. To remove ambiguity, the suggested definition explicitly refers to IA as a risk based concept since grounding the work of IA on the assessment and monitoring of the major areas of risks is fundamental.

While the official IA definition (IIARF 2011, 2) refers to an *"assurance and consulting activity evaluating and improving the effectiveness of risk management, control, and governance processes"* this study suggests, as far as the work of IA is concerned, a clearer emphasis on the primacy of assurance over consulting services, since the search for a balance between the two can be a challenge in practice. There are interesting parallels to the world of EA that deserve attention. Academic studies evidence that the provision of non-audit services can harm the external auditors' independence, consequently, SOX regulation in the U.S. limited the scope of advisory and consulting services. The simultaneous provision of assurance and consulting services by IA has not yet been adequately examined from that perspective. Further studies are encouraged, how an auditor in practice manages both, how the right balance between assurance and consulting services is determined in practice, and how independence may be affected.

When emphasizing the primacy of assurance services, I acknowledge that an effective assurance service typically has a consultative element, as pointing to a problem is important, so is helping to improve. To be clear, however, an IA service with no assurance content at all would not qualify as effective IA as defined here, usually not even as IA. While there are cases of IAFs in practice that perform solely consulting type of IA assignments, i.e., typically revenue enhancement or cost saving projects, I take a position in my dissertation, addressing Anderson's (2003, 120) question: *"Can an internal audit function only provide consulting services?"*

The study observes that IA effectiveness has a practical dimension, but it also has a political parameter, as there are multiple perspectives from which effectiveness can be judged. Wherever that is compatible with the respective corporate governance context, the study argues in favor of a direct (solid) reporting line between the CAE and the board/AC,

rather than between the CAE and SM, thus clearly having the oversight body as 'the first boss'. Such a configuration, giving more direct, formal and possibly personal access, may help to prevent SM filtering what IA reports to the board/AC such that only what is palatable to SM is communicated. In addition, this set-up may help the status of the IAF in an organization: typically what matters to the board/AC will matter to SM as well, because in turn SM also reports to that oversight body.

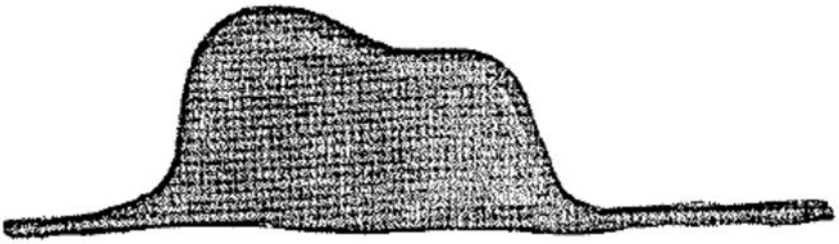
At the same time, this study acknowledges the prime importance of behavioral dimensions on IA effectiveness. This is because 'soft factors' emerge as highly relevant and can offset the otherwise restrictive aspects of structural limitations such that in practice, other structural set-ups may also work and not hinder IA effectiveness. The pattern of communication and interaction between the CAE and the other governance stakeholders, such as SM for example, is considered a key feature in determining IA effectiveness. In other words, in cases where the board/AC is not the chief stakeholder of IA, as in the German setting, real-world behavioral patterns, including how SM interacts with IA and (genuinely) respects its role and (potential) contributions, may prevail over the formal organizational set-up. This clearly suggests that there are also other contributors to IA effectiveness.

The study emphasizes that effectiveness (as defined and understood in this dissertation) is not a theoretical construct but a practically relevant outcome. For example, the IA report is viewed as an output that is effective only if it triggers intended positive change. Solving problems is what matters most as one CFO stresses in an interview *"good IA is judged by what is being done, not by what is being written."* The change in practice, the specific outcome, and (possibly) the lasting effects of the desired improvements relating to an area/process are relevant and important. The study points to the danger of IA reporting on auditors' action rather than on what is important to SM and/or the board/AC, and to the implications of governance (and risk and control). If CAEs do not provide reports that matter to SM and/or the board/AC, and if CAEs cannot make their points effectively, SM and/or the board/AC may not pay much attention to what IA has to say, particularly when they are under time pressure.

This dissertation goes beyond the consideration of what constitutes IA effectiveness, by providing insights into factors that can enhance and detract from it. With this as its main theme, this dissertation addresses Sarens' (2009) considerations pointing to the

characteristics of the IAF as a whole and of the individual auditor as key factors of effective IA. In the opening remark of my dissertation, I reference The Little Prince's (de Saint-Exupéry 1943) drawing number one that showed a boa constrictor digesting an elephant, a picture that symbolizes the 'black box' of IA effectiveness (Figure 3).

Figure 3: The Little Prince's drawing number one



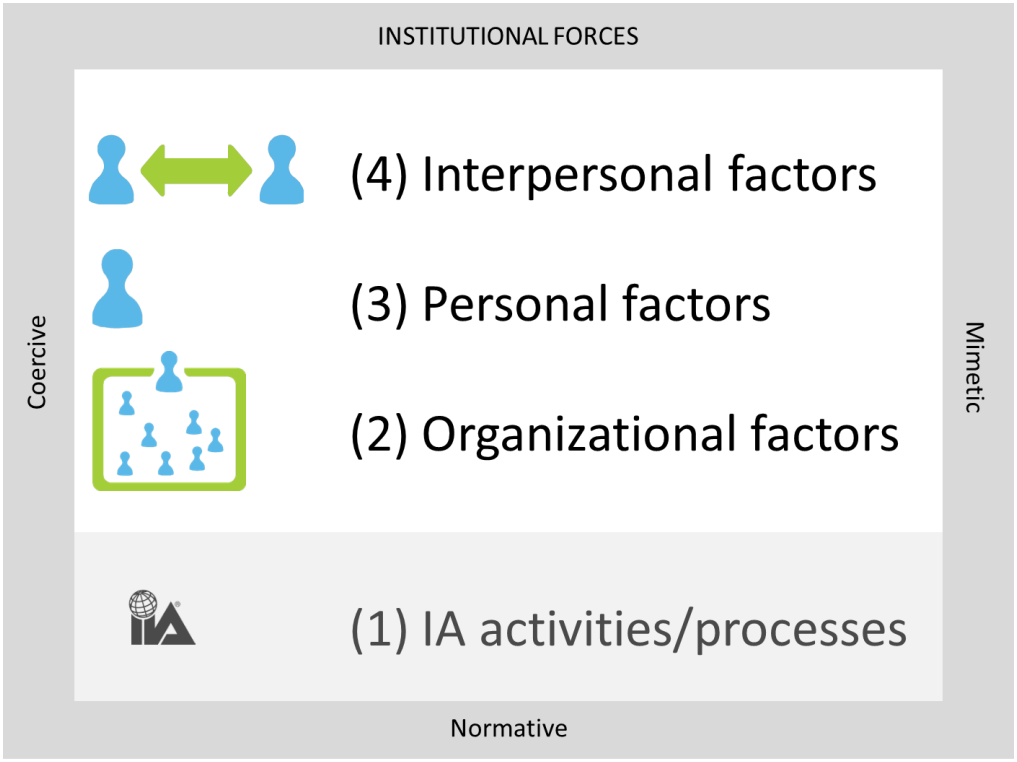
To bring out the main points of my dissertation I offer meta-conclusions that open a little the 'black box' of IA effectiveness by providing new categories, which contribute to it.

Meta-conclusions

This dissertation views IA effectiveness as a multi-faceted concept thereby distinguishing the macro- and micro-dimension.

The macro-dimension is captured by the three institutional forces of coercive isomorphism, normative isomorphism and mimetic isomorphism that literally frame my model and understanding of IA with normative isomorphism emerging as a weak force (Figure 4).

Figure 4: Meta-conclusions, part 1



In the context of IA, the three institutional forces[4] demand compliance with laws and regulations (coercive force), imitation of other IAFs by learning from and mimicking others' (best) practices and prescriptions from consulting firms (mimetic force), and adherence to the professional practices as promulgated by the IIA (normative force).

As this study shows, normative institutional forces influence IA effectiveness but they are comparatively weak. This study does not view compliance with the IIA professional practice framework as the reliable measure of IA effectiveness. More matters. IA effectiveness emerges in this study as a multi-faceted concept in which organizational, personal and interpersonal factors are identified as key variables.

When studying the micro-dimension, this dissertation points to four relevant dimensions: (1) IA activities/processes influenced by the normative force of the IIA, (2) organizational factors influenced by company specifics, as well as (3) personal characteristics of the CAE and (4) interpersonal factors that influence the relationship between the CAE and

[4] According to institutional theory (DiMaggio and Powell 1983) *"rational actors make their organizations increasingly similar as they try to change them"* as such actors respond similarly to three mechanisms - coercive forces, mimetic forces, and normative forces - causing what DiMaggio and Powell called *"institutional isomorphic change"*.

SM and between the CAE and the board/AC.

I cluster and summarize the key contributions and findings of this dissertation in the form of propositions. I start with the macro factors.

MACRO FACTORS OF IA EFFECTIVENESS

Coercive institutional forces influence IA effectiveness, but they are typically limited and often only indirect.

IA may be considered legitimate and effective if it complies with society's expectations in the form of regulation. In the example of the U.S., coercive force is applied in the form of a law (Sarbanes-Oxley Act) and formal regulations such as the New York Stock Exchange (NYSE) listing requirements. While the NYSE listing rules mandate the presence of an IAF, the size and nature of the function is not specified, and the NYSE does not address its effectiveness. In the European Union 8th Directive (2006/43/EC, Article 41), an IAF is not mandatory.

This study argues that there has not been any coercive force to have an *effective* IAF, while there has been limited and often only indirect coercive force on companies to have an IAF. Companies conform to laws to secure their legitimacy, so if having an IAF is legally required, organizations will have them. However, simply having an IAF says little about its effectiveness.

While regulators in some cases demand that firms have an IAF, they do not specify what they consider effective IA. Regulators appear to care little about regulating IA more fully, perhaps because they do not have a good understanding of IA's role and effectiveness, or because IA effectiveness is not regarded an area that needs to be regulated. The regulation of the role of IA in practice could be an important factor for creating a profession with a distinct identity. Such regulation may clarify the key roles and responsibilities of IA, for example, demanding that assurance services are the major scope of work (not consulting or advisory services) and that the board/AC is the ultimate addressee of the IA service rendered.

Notably, the updated guidance for supervisors when assessing the effectiveness of the IAF in banks, issued in June 2012, emphasizes the provision of assurance as core remit and

calls for a strong relationship between the IAF and the bank board/AC: principle 1 (BIS 2012, 4) demands that *"an effective internal audit function provides independent assurance to the board of directors and senior management on the quality and effectiveness of a bank's internal control, risk management and governance systems and processes, thereby helping the board and senior management protect their organization and its reputation."*[5]

However, regulation may well not be the silver bullet since more regulation may well not enable higher IA effectiveness. Ultimately, the level of IA effectiveness depends on the specific way organizations practice conformance and governance in a typically performance driven context. That practice is largely dependent on the behavioral pattern between the relevant stakeholders.

The EA profession is highly regulated, however, that does not necessarily correlate with higher EA effectiveness as evidenced by corporate failures associated with the financial crisis that started in 2007, where in some cases EA did not unearth problems in a timely manner, if at all. The Public Company Accounting Oversight Board (PCAOB) regularly reviews EA firms and provides firm inspection reports summarizing the deficiencies in the performance of the audit work.[6] This documents that a highly regulated profession may continue to perform (in parts) ineffectively.

Mimetic institutional forces matter, but IA effectiveness requires a shared understanding of what makes IA a value-added activity.

Organizations tend to model themselves after similar types of organizations that are considered successful and legitimate by their surroundings. From this perspective, IA may be considered effective when there is a legitimate, institutionalized model on which to base it. In this study, the expectations of SM, the board/AC and EA are regarded as mimetic forces on the CAE.

The working relationship between IA and SM, if effective, is a critical enabler for IA to exploit its potential. SM's support is needed for IAF in its daily activities, for example, to support and possibly help pushing for the timely and adequate remediation of critical

[5] Bank for International Settlements (BIS) (2012), Basel Committee on Banking Supervision, The internal audit function in banks, June. See www.bis.org (accessed on 17 November 2012).
[6] See http://pcaobus.org/Inspections/Reports/Pages/default.aspx (accessed on 17 November 2012)

issues raised by IA. As the multiple-case-study research also confirmed, open and direct communication, regular input into IA planning, a shared perspective on risk based IA and support of IA recommendations are elements of an institutionalized model that could provide legitimacy if an IAF followed it. IA effectiveness is nurtured in environments where SM has respect and appreciation of the work of CAE, where there is a clear and agreed purpose of IA, where there are common objectives and where there is a good (two-way) flow of communication (regularly, timely and problem solving oriented). This behavioral and relational dimension emerges as a crucial factor on IA effectiveness. In this dissertation, the theory of relational coordination (Gittell 2006) is provided as conceptual framework since it fits well into the context of IA and provides a sort of role model and the language to describe what 'good' (effective) IA looks like.

However, there can be cases where the actions of SM, who may be disinclined to benefit from the service that IA can provide, are neither competent nor ethical. Internal auditors may be intimidated by SM. It makes a fundamental difference whether SM wants, indeed facilitates IA looking at the right things, or whether SM has no interest in the work of IA and may not want IA to be effective.

Based on theoretical considerations, this dissertation argues in favor of regarding the board/AC as the chief stakeholder of the IAF and recommends a direct reporting line from the CAE to that oversight body, whenever that is compatible with the respective corporate governance context.[7] Typically, access to the board/AC can give the IAF a strong mandate, and represents a key feature of an institutionalized model that could provide legitimacy if an IAF followed it. Regular and timely communication with the oversight body may demonstrate shared knowledge and common goals, as well as an appreciation for the work rendered by the IAF.

External auditors are permitted by the International Auditing and Assurance Standards Board (IAASB) to review the work of internal auditors. EA typically views IA as auxiliary to EA's tasks, that is, by in-sourcing parts of EA's activities to save money and/or to make their work easier, and possibly more effective. This contribution by IA to the work of EA can be seen as a sign of appreciation and represents an institutionalized model for the IAF to mimic in order to gain legitimacy.

[7] This is a theoretical argument since my dissertation did not include the board/AC in the empirical part of the study due to constraints of accessibility.

Normative institutional forces influence IA effectiveness but they are comparatively weak.

The stronger the normative force of the IIA, the more effective the IAF may demonstrate itself to be by complying with IIA guidance. However, normative forces that demand compliance with IIA standards usually emerge as a weak force in empirical research. The normative guidance provided by the IIA has only been partially implemented in practice. The lack of compliance of IA practices with normative guidance may signal a lack of professional identity. Therefore, this study challenges the assumption that IA has an identity, as the IIA cannot enforce its standards in practice, and the effect of those standards is often negligible; for example, when CAEs do not comply with professional standards there is no reliable mechanism with which to 'punish' them. IA lacks exclusivity and uniqueness, and its value proposition, as promulgated by the IIA standards is viewed as 'soft text.' As the identity of IA is not sufficiently clear, the normative pressure to make IA effective is comparatively weak.

Therefore, the IIA should consider ways to increase its normative force, perhaps by solidifying the value proposition of IA. This issue deserves attention by the IIA if it wants to increase compliance with its professional standards. The IIA may consider crystalizing (solidifying) its definition and identifying its distinct role more clearly in order to provide opportunities for more homogeneity in practice. It seems reasonable to assume that the normative force will not have a stronger impact unless there is a minimum level of coercive force that demand organizations to have an effective IAF and specifying its key features as discussed in this study. Such regulatory action is expected to help IA to gain a stronger identity.

The three institutional forces can be in conflict with each other and/or with organizational demands, which may cause a dilemma for the CAE.

The literature review shows that the three types of isomorphism may draw IA in different directions and/or conflict with organizational demands, causing dilemmas for CAEs who want to establish an effective IAF.

In cases where macro and micro forces are in conflict with each other, the CAE has to decide what he or she gives priority to. Unless the isomorphic pressure stems from coercive force, it is typically likely that micro factors prevail because IA is first and foremost an internal monitoring mechanism working for internal stakeholders. This

distinguishes IA from EA where the macro forces are comparatively more important because EA is an external monitoring mechanism working for shareholders, banks and other external parties including 'the society'.

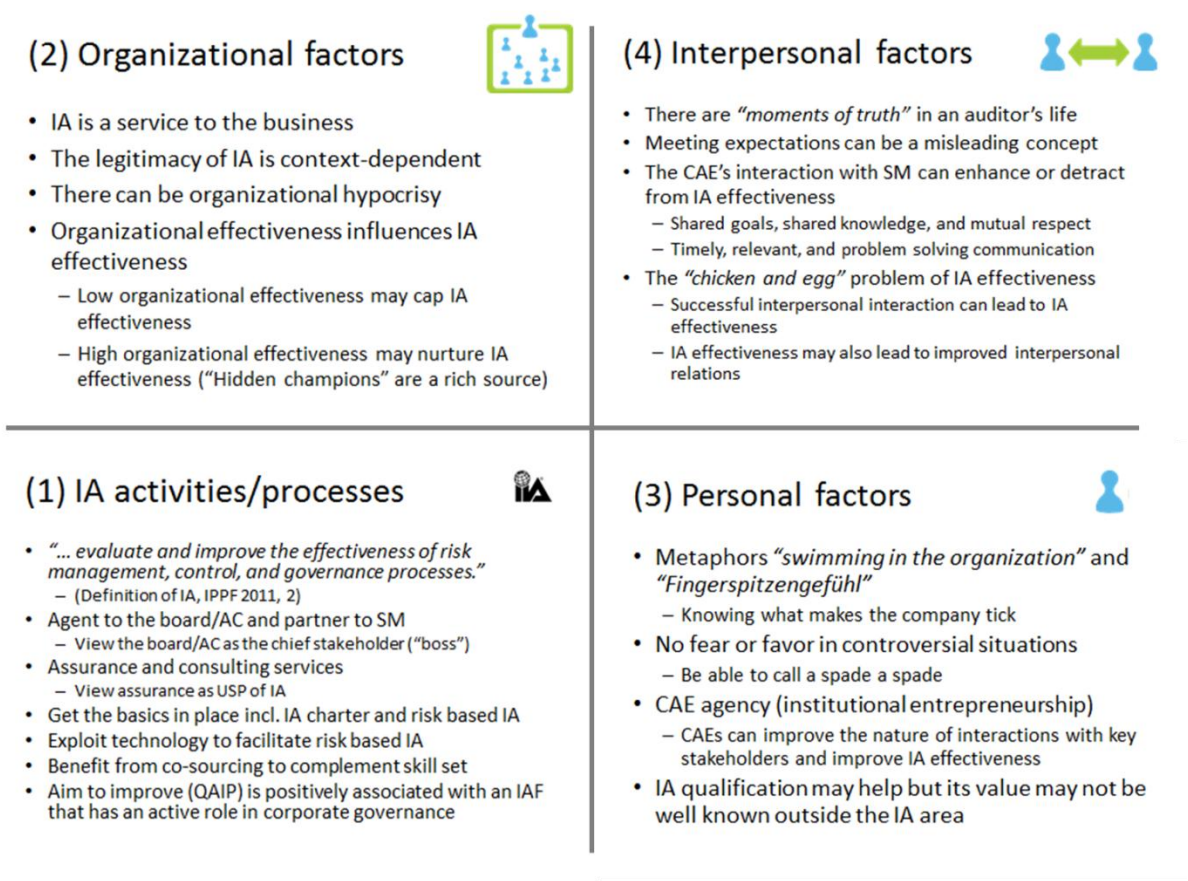
When the three types of isomorphism draw IA in different directions and/or conflict with organizational demands, his study puts forward two possible ways of resolving the dilemma; 'CAE agency' (→ personal factors) and 'organizational hypocrisy' (→ organizational factors).

- 'CAE agency' points to the possibility that CAEs emerge as agents, who challenge and initiate to alter 'the way we do things' in an organization, especially as far as governance is concerned. Initiating and possibly implementing change is expected to require particular personal characteristics and competences in liaising successfully with auditees, SM and the board/AC, including business acumen, leadership and communication skills, listening and influencing skills and relationship acumen.

- 'Organizational hypocrisy' may develop when organizations respond to inconsistent norms by creating inconsistencies among talk, decision and action in order to cater to the different expectations. It labels situations that are characterized by dissonance between rhetoric and practice.

To view and further discuss the micro-level factors of the presented multi-level IA effectiveness model I open the 'black box' of IA effectiveness a little further (Figure 5).

Figure 5: Meta-conclusions, part 2



MICRO FACTORS OF IA EFFECTIVENESS

(1) IA ACTIVITIES/PROCESSES

The IA profession has been largely ignored in the governance debate on solutions after the 2007 financial crisis because it lacks a clear chief stakeholder and a clear role.

IA has not been seen to play a significant role in the financial crisis, as either part of the problem or part of the solution. New knowledge is provided to the academic literature in the form of an explanation for the IA profession's marginalization in the governance debate after the 2007 financial crisis.

The study shows that positioning IA as both an agent to the board/AC and a partner to management is challenging in practice, so this dissertation suggests that CAEs clarify the customer dimension of their organizational context. This dissertation argues in favor of viewing the board/AC as IA's chief stakeholder ('the first boss') when that is compatible with the respective corporate governance context, while acknowledging the important role

of SM for IA to be effective. Moreover, this dissertation argues in favor of consolidating IA around its core function of providing assurance. This dissertation suggests assurance as the unique selling proposition (USP) of IA.

In the 2013 edition of IIA's standards[8], which are best practice guidelines since the IIA has no regulatory authority to enforce them, there are two additional examples for what functional reporting to the board involves when interpreting Attribute Standard 1110 (Organizational Independence): *"Approving the internal audit budget and resource plan"* and *"Approving the remuneration of the chief audit executive"*. With these additions, it seems that the new IIA standards intend to strengthen the CAE's link to a company's board/AC. In doing so, the *"new guidance could add teeth to Internal Audit"* (Hoffelder 2012).[9]

Presently, the macro level forces to establish an effective IAF are relatively weak, thus, choices are largely determined on the micro level, that is, within the organizational context, which is embedded in the respective corporate governance framework. This dissertation encourages the IIA to consider further clarifying the customer dimension of IA services and determining the board/AC as the 'boss' of IA, thereby increasing the normative force.

In addition, as the normative force may require a minimum of coercive force, this dissertation argues in favor of tightened and refined regulatory pressure, demanding organizations to not only have an IAF (or explain why they do not have one) but to have an *effective* IAF. Such an institutionalized model may help the IA profession to create a stronger identity built around its core value proposition of assurance services and, increased legitimacy, provided the IAF and the business/organization it works for conform.

Ultimately, the role of IA is negotiated - openly or factually – at the micro level, in the organizational context, primarily among the governance stakeholder, SM, the board/AC, EA and IA. While this dissertation views the combination of assurance and consulting as potentially confusing, and may dilute IA's value proposition, micro level forces will

[8] The Institute of Internal Auditors (October 2012): International Standards for the Professional Practice of Internal Auditing (Standards), Markup changes comparing 2013-01 versus 2011-01

[9] Hoffelder, Kathleen (2012), New Guidance Could Add Teeth to Internal Audit, in: CFO.com, October 24, 2012

largely determine the type of IA an organization has, especially while macro level forces remain weak.

The use of a risk based audit plan and a quality assurance and improvement program, as well as AC input into the audit plan, are associated with the IAF's role in corporate governance.

IA's influence on governance is the yardstick of 'goal-attainment' as defined in this dissertation. The UK corporate governance code (FRC 2012) defines *"the purpose of corporate governance is to facilitate effective, entrepreneurial and prudent management that can deliver the long-term success of the company"* but there is no universally accepted definition. Governance is associated with decision-making about risks and rewards with the (long term) enterprise and shareholder value on mind.

This dissertation is the first to examine the factors that affect the IAF's role in corporate governance, which is a significant contribution to academic literature. The study shows that an IAF that has an active role in corporate governance is significantly and positively associated with the firm's use of a risk based audit plan, a quality assurance and improvement program (QAIP), and AC's input into the audit plan. These findings have implications for CAEs who want to increase their IAF's role in corporate governance.

Have the basics of IA in place

This dissertation shows that some IAFs do not have the basic cornerstones of IA in place. Some IAFs do not have an IA charter that clearly defines the role and mandate of IA in the organization, and risk based IA is often not applied. If CAEs want to enhance the effectiveness of their IAF, this is the area in which to start.

The IA charter that is agreed by the board/AC and SM may be seen as a kind of 'micro level coercive force', for the agreed IA charter clarifies, why there is an IAF and what it is tasked with doing. When seeking to establish an effective IAF, clarity of the IAF's purpose and mandate in the respective organizational context are prerequisites. In this study, shared goals and shared knowledge emerge as key features of the effective IAF. Agreeing on and committing to an IA charter represents also a sign of respect by the board/AC and SM. In doing so, there needs to be communication and mutual understanding.

Exploit technology

This dissertation shows that some IAFs benefit from audit analytics like computer assisted auditing techniques (CAAT), while others do not. The evidence of this study may indicate that the more effective IAFs tend to benefit more fully from exploiting technology. The right use of technology can be an enabler of IA effectiveness. Audit technology may, for example, facilitate follow-up, strengthen risk based IA planning, and allow continuous risk assessment by identifying indicators (red flags) of potential fraud when screening business transactions as they occur.

Benefit from co-sourced IA services

This dissertation shows that some IAFs benefit from co-sourcing, while others do not. The evidence of this study may indicate that the more effective IAFs know their own limitations, and complement their skill set as needed, which is regarded as positive. Co-sourcing may be a good strategy of the effective IAF where there is, for example, a lack of expertise and competency or a major transformational project that requires special attention. If co-sourcing is completely disregarded, there is a danger that IA staffing constraints result in scope limitations, which, in turn, may impair risk based IA.

Training and continuous learning

This dissertation shows that the level of training and continued learning emerges as differentiating characteristics of IAFs. The study indicates that there are more effective IAFs, which require IA staff to have or to be working towards an IA qualification, on the other hand, only a fraction of the arguably less effective IAFs place such a demand on their staff. If the CAE wants to improve the effectiveness of the IAF, adequate attention should be given to training. It may sound trivial that training is important, however, in practice that may separate the wheat from the chaff. Aiming to improve and having a quality assurance and improvement program (QAIP) in place, is also positively associated with the IAF's role in corporate governance.

(2) ORGANIZATIONAL FACTORS

The legitimacy of IA is context-dependent. Hidden champions are a promising field and a rich source in understanding IA effectiveness.

In this study, IA has been viewed as effective when it helps organizations achieve their objectives. The contribution and role of IA and what "goal-attainment" of the IAF means in practice is largely determined in the organizational context, among SM, the board/AC, EA and IA. In the absence of strong external, coercive pressure, micro level forces presently outweigh macro level influences. The study shows that organizational characteristics as a micro level force matter. As organizational contexts vary, so do IAFs. Ultimately, organizations have the IAF they want. The legitimacy of IA is context-dependent, and what provides legitimacy in one context might not in another.

Empirical theory suggests that organizational factors are important in establishing IA effectiveness. This study specifically underpins this premise by providing insights into *hidden champions* and their IA practices. That umbrella term refers to a group of companies with similar characteristics, the members of which among other things, are market leaders in their industry, and have a low level of awareness among the public because they tend to be active in business-to-business markets and have little or no interaction with the end consumer. Hidden champions are very successful enterprises and it is reasonable to assume that they typically render superior profits to their owners.

This research discovered that hidden champions in particular demand and benefit from effective IA practices and may be a particularly rich source of information in understanding IA effectiveness. This insight provides a novel and specific contribution to academic research. Three out of five cases that belong to the group of companies clustered as hidden champions are in the top half of the sample base in the multiple-case-study research (cases A, D and F), which supports the assumption that organizational factors influence IA effectiveness, as hypothesized in applying role theory (Kahn *et al.* 1964, factor O). All hidden champions in the sample base have an IAF at their own discretion. The IAF may be small or large, it seems, if hidden champions choose to establish and maintain an IAF they seriously endeavor to get something relevant and helpful out of it, a return that justifies the investment. The IAFs of hidden champions operate in the limelight. The IAFs of hidden champions are not at all alien to the rest of the organization, not a kind of bolt-on, on the contrary, they are an integral part of the business, a feature of the 'way we do things'.

The link between organizational factors and IA effectiveness deserves further attention in empirical studies. As high organizational effectiveness nurtures IA effectiveness, low

organizational effectiveness may hamper it. To date, hidden champions remain an under-explored source of knowledge, as they typically prefer to remain hidden to protect their competitive advantage. A single-case, possibly longitudinal study that researches IA practices within this type of firm is recommended and expected as having revelatory potential.

There can be organizational hypocrisy.

Prior studies have pointed to the importance of the politics and culture of an organization. This study is complementary by pointing to the possibility of organizational hypocrisy, dissonance between rhetoric and practice. Such inconsistency between talk and action can be a deliberate response to inconsistent institutional pressures and/or organizational demands.

The IIA's lack of enforcement or interest in whether its members comply with its standards may be viewed as an example of such hypocrisy, thereby acknowledging the overall weak nature of isomorphic (macro) forces. On a micro level, one IAF that was examined in the multiple-case-study may serve as reference. The CAE in question is fully aware that he is leading a subpar IAF with no IA resources at all for a long period of time. He reports to the deputy-CEO who acknowledges that the IAF is understaffed but he is still *"pleased with the work rendered by internal audit based on the available resources."*

When abstracting from this anecdotic evidence to further nuance the argument, there can be situations in practice, for example, when SM hypocritically ignores dubious practices applied to meet ambitious sales targets. SM may rhetorically underline the importance of governance and conformance with company or accounting standards, but despite the rhetoric, in delicate trade-off situations, meeting (short-term) performance targets may dictate what may be quite different.

IA effectiveness as defined in this dissertation is seen as a matter of action and not rhetoric, so the outcome of IA work may render an IA service as effective, the rhetoric in the IA report is not sufficient, but the IA report can be a means to an end. Since rhetoric and action may be easily confused in practice, the possibility of hypocrisy in IAFs opens an arena for further studies.

(3) PERSONAL FACTORS

'Swimming in the organization' and 'Fingerspitzengefühl' characterize the successful internal auditor.

This study introduces metaphors, to characterize the effective internal auditor, including the attribute of 'Fingerspitzengefühl' and the ability to 'swim in the organization'. 'Fingerspitzengefühl' is an umbrella term that encapsulates what successful internal auditors can do well: be skillful when dealing with people, establish relationships and ask the important questions in an empathic and intelligent fashion. Professional sociability is a key success factor for internal auditors, who must establish new working relationships quickly before moving on to the next assignment. 'Swimming in the organization' is a metaphor, evocative of an effective internal auditor who represents an effective IAF; such internal auditors know what is happening in the company, they network well and speak with everyone in every function and at all levels in the organization. The CAEs of hidden champions resemble the role model of an effective internal auditor who is 'swimming in the organization'. The link between personality factors and IA effectiveness deserves further attention in empirical studies.

In controversial situations, successful internal auditors have no fear or favor.

It is important that the CAE confidently and reliably reports what he or she has to say, without any fear of negative career repercussions. Successful internal auditors must possess a high level of integrity. To be seen as credible, internal auditors must fight any bias in their judgments. The CAE in one of the companies examined in the multiple-case-study benefits from clear and aligned expectations from the CEO who wants him to have no fear or favor and he literally says, *"the successful CAE needs to maintain his independence, needs to work as objectively as possible and remain neutral, and must be able call a spade a spade."*

CAE agency can improve IA effectiveness.

This dissertation points to the possibility of CAE agency. Empirical research has generally viewed agency one-dimensionally: the stereotypical model is that the board/AC and/or SM have expectations that IA tries to learn and match. The stereotypical CAE may change from trying to meet others' expectations (which may be divergent, hazy or non-

existent) to becoming an agent who drives change. The CAE may become a change agent, challenging institutionalized practices.

CAEs can improve the nature of interaction with key stakeholders and enhance IA effectiveness. In situations, where institutional forces point in different directions, or conflict with organizational demands and/or the values for which IA stands, CAE leadership (bottom-up agency) may emerge, setting and driving the agenda, especially in governance related matters. Micro forces (field characteristics) are important parameters that largely determine whether CAE agency or organizational hypocrisy emerge to resolve the dilemma.

Bottom-up agency (CAE agency) is expected to be much more difficult to implement than top-down agency. Consequently, CAE agency may be a rare phenomenon in practice, which is a good reason to search for it. The CAE who becomes an institutional entrepreneur must present an IA value proposition that addresses key stakeholders' expectations and problems.

CAE agency is suggested as a new field for empirical research. This perspective has been under-examined in practice. New insights from such cases of CAE agency, possibly by means of longitudinal studies, may add new knowledge, help to enhance the curricula of IA studies and training and may help the IIA to achieve broad recognition of IA as a profession.

IA qualification can help but its value may not be well known outside the IA area.

The value of IA qualifications held by staff and CAEs was confirmed by the empirical survey, which revealed CAEs IA qualification as a differentiating characteristic between the two groups studied. Notably, that study was based on the self-assessment of CAEs. However, in the multiple-case-study, four out of five CAEs identified as heading effective IAFs had no IA qualification. That suggests that having an IA qualification may be over-valued by the IIA and its members and may be misinterpreted as a sign of competence.

When comparing the qualifications of professionals in IA with those in EA, there are some striking differences, worth studying further. In the case of EA, the designation of Certified Public Accountant (CPA) or equivalent is the statutory title of qualified accountants and a prerequisite, sort of an indispensable admission card for a career in that

profession. In the case of IA, the designation Certified Internal Auditor (CIA) from the IIA U.S. Inc. or, for example, the designation Chartered Internal Auditor (CMIIA), from the IIA UK and Ireland, are not at all mandatory for a CAE when leading an IAF. Neither normative nor coercive forces request the CAE to be qualified as internal auditor. In the case of EA, most professionals stay long term and typically commit their entire professional career to EA, whereas in the case of IA, many internal auditors stay only for a limited stint. To sum up, while the CPA designation is stipulated by law and highly recognized universally, presently the CIA or CMIIA designations lag behind.

This finding suggests that IA qualifications are not well known outside the IA area and that they are not important to those to whom the CAEs report. In addition, this finding poses questions about the value of the educational content in the IA qualification process and the perceived value and benefit of IA qualifications for the most senior members of the IA profession - the CAEs. The practical benefit of such qualifications may be heightened by reviewing the curricula and increasing the practical usefulness of IA degrees, especially for CAEs.

(4) INTERPERSONAL FACTORS

There are 'moments of truth' in an auditor's life.

This study shows that there can be 'moments of truth' in the relationship between the CAE and SM that determine whether the CAE ultimately succeeds or fails.

There are cases in which the communication between the CAE and key stakeholders is infrequent and delayed, if it happens at all. While the demographic data of the companies C and D in the multiple-case-study look very similar (same industry, similar size in terms of revenues and staffing) they are quite different since the CAE in case C is entrenched and has almost given up. He may already have resigned in spirit. The present relationship between CAE and SM and their communication protocol was determined by a 'moment of truth', a watershed event: an attempted risk-assessment by the CAE was stopped by the then deputy-CEO sensing unwelcome side effects. Since then, all communication for input to a risk based IA plan has been exclusively channeled through the deputy-CEO. The CAE of case C heads a comparatively empty shell. This is anecdotal evidence that there can be 'moments of truth' in an auditor's life.

When describing these 'moments of truth' in a more general way, I argue that the CAE who personally presents the key findings of his IA work to SM and/or the board/AC is exposed to the critics in that audience. Such presentations and discussions are also 'moments of truth' as they make the contribution of IA discernible - or not. 'Moments of truth', also moments of conflict and discomfort may be highly significant factors on IA effectiveness, so they deserve additional attention in empirical research.

Meeting expectations can be a misleading concept.

The study suggests that meeting expectations from SM as a criterion for measuring IA effectiveness can easily be misleading, as expectations vary widely in practice, and they may demand very little of the IAF. This insight is a new and innovative contribution to the empirical literature. Consequently, the suggested definition of IA effectiveness uses the IA's 'positive influence on governance' as the yardstick, thereby specifying what 'goal-attainment' means.

The CAE's interaction with SM can enhance or detract from IA effectiveness.

The study shows that interpersonal relationships are key determinants of IA effectiveness and that we must study the behavioral and relational dimension to understand IA effectiveness. There is a fundamental difference in the effectiveness of the IAF depending on whether SM, perhaps pushed by the supervisory board or the owners, supports the IAF and wants it to examine the right issues, or whether SM is passive and/or does not want the IAF to unearth certain matters.

CAEs who interact *frequently* and in a *timely* manner with SM, using *problem-solving communication*, help and nurture IA effectiveness, especially when communication is supported by *shared goals, shared knowledge and mutual respect*. CAEs who interact *infrequently* and in a *delayed* manner with SM, using *finger-pointing communication*, hurt and impede IA effectiveness, especially when communication is characterized by *functional goals, exclusive knowledge* and *disrespect*.

The few guiding principles contrasting the communication protocol and attributes at the extreme ends of the continuum, provide a helpful framework and language to describe what 'good' (effective) and 'bad (in-effective) CAE-SM relations typically look like. The application of Gittell's theory (2006) is well suited in the context of IA including, as it

does a degree of repeated work processes. The work of IA is standardized as there are defined processes (methodology) to follow, but the content, the context and specifics of the audit mission are always different. IA makes connections when crossing functional silos. IA typically operates under some time pressure to complete the assignment in due course – and some risks may need urgent 'treatment'.

The 'chicken and egg' problem of IA effectiveness

While this study points to the important influence of the relational dimension between CAE and SM, there is sort of a 'chicken and egg' problem in IA. The influence of the relational dimension between CAE and SM is viewed as important, but there is no knowledge about the direction of the effect.

Successful interpersonal interaction can lead to IA effectiveness. Until now, however, the 'causality' suggested in Gittell's theory (2006) has never been tested. There are no studies yet that prove 'causality', even not in other areas. Therefore, in some cases the direction could theoretically be reversed, that is, IA effectiveness may also lead to improved interpersonal relations. In other words, if IA is really 'good' (strong/effective), then when SM realizes this, the nature of CAE/SM interactions may improve. Likewise, if IA is really 'bad' (weak/ineffective), then SM may largely choose to cut-off communication. We do not know to what degree that consideration has influenced SM's communication pattern, for example, in case C (in the multiple-case-study). Future research is encouraged to provide further insights into this 'chicken and egg' problem, namely the causality of effective IA.

The main contributions of my dissertation differ for academia, IA practitioners, and the IIA, as summarized below.

For academia:

1. This dissertation uses the perspective of new institutional theory and entrepreneurship as a framework when providing a review of the existing empirical literature on IA effectiveness. As far as giving IA an identity, the three isomorphic forces (coercive, normative, and mimetic) emerge as rather weak.

2. This dissertation offers an explanation why IA is not seen to have had a significant

role in the financial crisis, neither as part of the problem nor as part of the solution: IA has no clear chief stakeholder and no clear role. Viewing the board/AC as IA's 'boss' and assurance services as IA's USP are suggested solutions to consider.

3. This dissertation defines IA effectiveness as a 'risk based concept that helps the organization to achieve its objectives by positively influencing the quality of corporate governance'. That useful definition for the purpose of this research may also be of value to the IIA and IA practitioners.

4. This research includes the first study that explores the variables that are associated with the IAF's role in corporate governance. Knowing about the significance of a risk based audit plan, AC's input and the quality assurance and improvement program, may help IA practitioners who wish to increase their influence on governance.

5. This dissertation is one of only a few studies and the first one in the German context, in which CAEs and SM in the same organization are interviewed to enhance the body of knowledge on IA. One of the dissertation's contribution to academia is the provision and application of theories by combining the classical view of role theory (Kahn *et al.* 1964) with the contemporary view of the theory of relational coordination (Gittell 2006) that have not been applied in an IA context before, and that represent an original theoretical lens, a promising framework for further IA studies.

6. This study shows that IA effectiveness does not operate in isolation because the IAF is not an island. Micro level forces largely determine the type of IAFs that organizations have. High organizational effectiveness nurtures and low organizational effectiveness may hamper IA effectiveness. To understand IA effectiveness, we need to consider the organizational context, view the characteristics of key stakeholders, and examine the behavioral and relational dimension among them.

7. This dissertation supplies a fresh agenda for future research opportunities, which encourages further studies on the effectiveness of IA.

For IA practitioners:

1. This study suggests what CAEs should focus on in order to increase the effectiveness of their IAF, and/or to enhance its role in corporate governance.

2. The study shows that IA effectiveness measures are bound contextually, and that in practice, there can be role ambiguity and role conflict. Customers' expectations may be divergent, hazy, or non-existent. The CAE should clarify the customer dimension and the purpose and mandate of its IAF in the respective organizational context.

3. This study introduces metaphors to characterize the effective internal auditor: 'Fingerspitzengefühl' encapsulates what successful internal auditors can do well. 'Swimming in the organization' is evocative of an effective internal auditor who represents an effective IAF.

4. A major contribution to practitioners is the importance of taking on a more proactive role, as the CAE has the opportunity to drive the IA agenda. The CAE may consider offering solutions to positively influence governance and, thereby, help the organization to achieve its objectives.

As for contributions to the IIA:

1. The dissertation shows the normative forces that demand compliance with the IA's common body of knowledge to be comparatively weak at this time. The IIA should recognize that the value of IA's work is questioned and that its goal of becoming a globally recognized and fully-fledged profession by 2014 is at risk unless the IIA acknowledges that there is a problem with its value proposition and talent pool.

2. The study suggests improvements to the IA value proposition. The study encourages the IIA to clarify its core remit and determine a chief stakeholder; that is, focus on the concept of assurance (at the expense of consulting) and more clearly emphasize the link between the CAE and the oversight body.

3. The IIA should review its curricula and consider ways to increase the relevance and practical usefulness of IIA degrees, especially for CAEs, if it wants those qualifications to be valued by CAE's and their primary customers.

The findings have generally been quite consistent throughout my research; however, there are two inconsistencies. Firstly, based on the self-assessment of CAEs in the U.S. (paper 2, hypothesis 4), while there was no significant relationship between an IAF's active role in corporate governance and SM input for audit planning, the relationship is regarded as an important enabler for the IAF to be effective based on all other studies. This particular outcome of the U.S. study based on the self-assessment of CAEs may not be generalizable as there can be big differences between countries. For example, in Germany the CAE typically reports into SM whereas in the U.S. the CAE typically has a direct reporting line to the board/AC.

Secondly, CAE's certification is positively associated with the IAF playing an active role in corporate governance (paper 2, based on the self-assessment of CAEs in the U.S.), and the importance of CAE's certification also came through when testing the discriminatory power of characteristics of IAFs (paper 4, based on the self-assessment of CAEs in Germany). The U.S. result may be impacted by the popularity and recognition of the CIA designation in that country possibly benefitting from the long history and roots of the IIA in the U.S. However, this favorable assessment was not supported by the interview based study. In that study which included SM as major stakeholder only one of five CAEs who are regarded as heading comparatively more effective IAFs has an IA degree. It may well be that the practical benefit of IA qualifications for CAEs is overvalued by internal auditors due to an inherent self-assessment bias. Further study is suggested to better understand the relevance of IA degrees in practice, as there are indications that many effective CAEs do not have such qualifications and many ineffective CAEs do, thus possibly signaling competence that is not actually there.

Applying risk based IA, having shared goals and ensuring shared knowledge with key stakeholders are helpful guiding principles for effective IAFs. Building adequate relationships sustained by ongoing and open dialogue are key aspects of effective internal auditors. The study confirms that the expectations of key stakeholders are important. However, it observes that such expectations can be vague and/or in conflict, and different stakeholders may have different views on what the IAF should do and focus on. As IA is a service to the organization it supports, there is not a one-size-fits-all IAF, which is probably also the reason why it is so difficult to regulate the profession.

Future research opportunities

When considering the phenomenon of IA effectiveness the study provides valuable insights, however, there are more questions than before and more questions than answers. So, my dissertation concludes by making suggestions for future research that build on this dissertation. The IA research proposals are clustered around the major themes of activity and purpose, corporate governance, organizational factors, personal(ity) factors, interpersonal factors, regulation and the IA profession. The list of suggested research questions ends with the search for hard measures of IA effectiveness.

A) IA ACTIVITY AND PURPOSE

1. What do we actually know about the core concept of 'providing assurance'?

2. What does 'right balance' between assurance services and consulting engagements precisely mean and how is it found in IA practice?

3. What are the differences and/or similarities between the 'assurance and consulting concept' of IA and in the EA profession?

4. Can it be empirically confirmed that the more effective IAFs often oversee risk management and sometimes also compliance, considering research about a more integrated assurance function?

5. Is there hypocrisy in IA, that is, dissonance between rhetoric and practice, and if so, what useful purpose may it serve?

6. Why does the IIA definition describe IA as an 'activity' and not emphasize the 'product/service and/or outcome' that IA offers, and how can IA improve its value proposition for its key stakeholders? Is that part of the IA profession's challenge/problem?

7. What do we know about the rationale and considerations (pros and cons) in practice for rating (or not rating) individual findings and grading (or not grading) the overall IA report?

8. What can we learn from the moments of discomfort experienced by CAEs and conflict with other governance stakeholders, which may be highly significant

factors of IA effectiveness?

9. Why do some IAFs completely refrain from complementing their skill set by co-sourcing activities and thereby possibly limiting their focus?

10. What can we learn from metaphors about IA?

B) IA AND CORPORATE GOVERNANCE

1. What is the relationship between CAE's professional/personal characteristics and the IAF's role in corporate governance?

2. What is the relationship and influence of IA work (and its quality/effectiveness) on board effectiveness and vice versa?

3. What can we learn from research on corporate governance disasters when exploring what the IAF has or has not done, possibly helping to color the image of what an effective IAF looks like?

4. What is the impact of different governance environments on the role and effectiveness of IA when comparing, for example, the one-tier board structure (like in the U.S. and the UK) with the two-tier board structure (like in Germany) and/or the more *"comply or explain"* (like the South-African King III, 2009) versus the *"comply or else"* (like in the U.S. where having an IAF is a mandatory NYSE listing requirement) type of regimes?

5. Under which conditions can reliance by EA on IA be a helpful indicator of IA effectiveness, and when can it be dangerously misleading?

C) IA AND ORGANIZATIONAL FACTORS

1. What is the relationship and influence of IA work (and its quality/effectiveness) on organizational effectiveness and vice versa?

2. What is the influence of organizational factors and associated corporate cultures on IA effectiveness, perhaps by studying *"hidden champions"* (Simon 2009)?

3. Why do some IAFs have no charter that clearly scopes the role and mandate of IA in the organization?

4. What is the influence of the organizational life-cycle and maturity on IA effectiveness?

D) IA AND PERSONAL(ITY) FACTORS

1. What can we learn about the influence of personality factors on IA effectiveness by exploiting the metaphors of 'swimming in the organization' and 'Fingerspitzengefühl'?

2. What can we learn about the influence of personality factors on IA effectiveness from a formal psychometric profile of the CAEs and correlate professionally revealed personality types (e.g., Myers-Briggs Type Indicator) with the effectiveness of their IAF?

3. Can the CAE become a change agent, and if so, what are favorable conditions for doing so?

4. What are career patterns of CAEs/internal auditors and on what basis are career choices made to move into the IA profession and out again?

5. Why is IA typically a rather short stint and stepping-stone to something else whereas EA has clear career paths offering life-long professional commitment?

6. What do we know about the effectiveness of career auditors versus those who stay in the profession only temporarily and who have experienced other activities prior to entering the auditing field?

7. Is there some optimum life cycle phenomenon for performing IA most effectively, for example, between three to seven years, so after some time of induction until a turning point after which internal auditors/CAEs may become too comfortable and lose their cutting-edge abilities?

E) IA AND INTERPERSONAL FACTORS

1. What do we know about IA as a credence good (Causholli 2009) and the influence

of soft factors on IA effectiveness, possibly building on The Little Prince's (de Saint-Exupéry 1943) key message *"What is essential is invisible to the eye"*?

2. How can we resolve the 'chicken and egg' problem in IA effectiveness? What do we know about the causality of effective IA? While the influence of the relational dimension between CAE and SM (and the board/AC) is viewed as important, there is no knowledge about the direction of the effect. Successful interpersonal interaction between the CAE and SM (and the board/AC) can lead to (perceived) IA effectiveness. On the other hand, rendering an IA service that is perceived as effective may also lead to improved interpersonal relations. (Experimental research is encouraged to provide further insights into this 'chicken and egg' problem, namely the causality of IA effectiveness.)

3. When measuring IA effectiveness, is using the extent to which SM's expectations are met the silver bullet or in practice, can that be misleading as SM may have very low expectations of IA?

4. When measuring IA effectiveness, is using the extent to which board's/AC's expectations are met the silver bullet or in practice, can that be misleading as the board/AC may have very low expectations of IA?

F) IA AND REGULATION

1. Why is there no corporate governance code that both gives a practical definition of and demands 'effective IA'?

2. Can IA effectiveness be legally required, or is it more a matter of 'gardening'?

3. Why should the regulator care more about regulating IA?

G) IA AND THE IA PROFESSION

1. Should the IIA solidify the value proposition of IA in order to enhance its normative force and help to professionalize IA, and if so, what level of coercive force is required as minimum?

2. What are the pros and cons of setting IIA standards as a descriptive code of practice or as a progressive normative standard?

3. Is there more coercive force needed, for example, what are the pros and cons that anyone (with or without an IA qualification, or equivalent) can sign and issue an IA report?

4. As reaction to what happened during and after the financial crisis that began in 2007, will the IIA abandon the concept of IA being partner to SM and agent to the board/AC and further emphasize the reporting lines of IA to the board/AC to avoid any confusion about who is the chief stakeholder of IA, that is the *"boss of IA"* as Chambers (2008) called it?

5. Does the plethora of IA degrees and designations dilute the value such certification could have and impair the identity of IA professionals on whom they are bestowed?

6. Does intra-profession competition with two dominant organizations for internal auditors co-existing, the IIA and ISACA (formerly the Information Systems Audit and Control Association), and even between the IIA institutes (U.S., UK, and Australia) help or hinder the IA's efforts to be recognized as the one and only professional body for IA?

H) HARD MEASURES OF IA EFFECTIVENESS

1. Are there hard measures of IA effectiveness or is IA effectiveness ultimately all about soft factors?

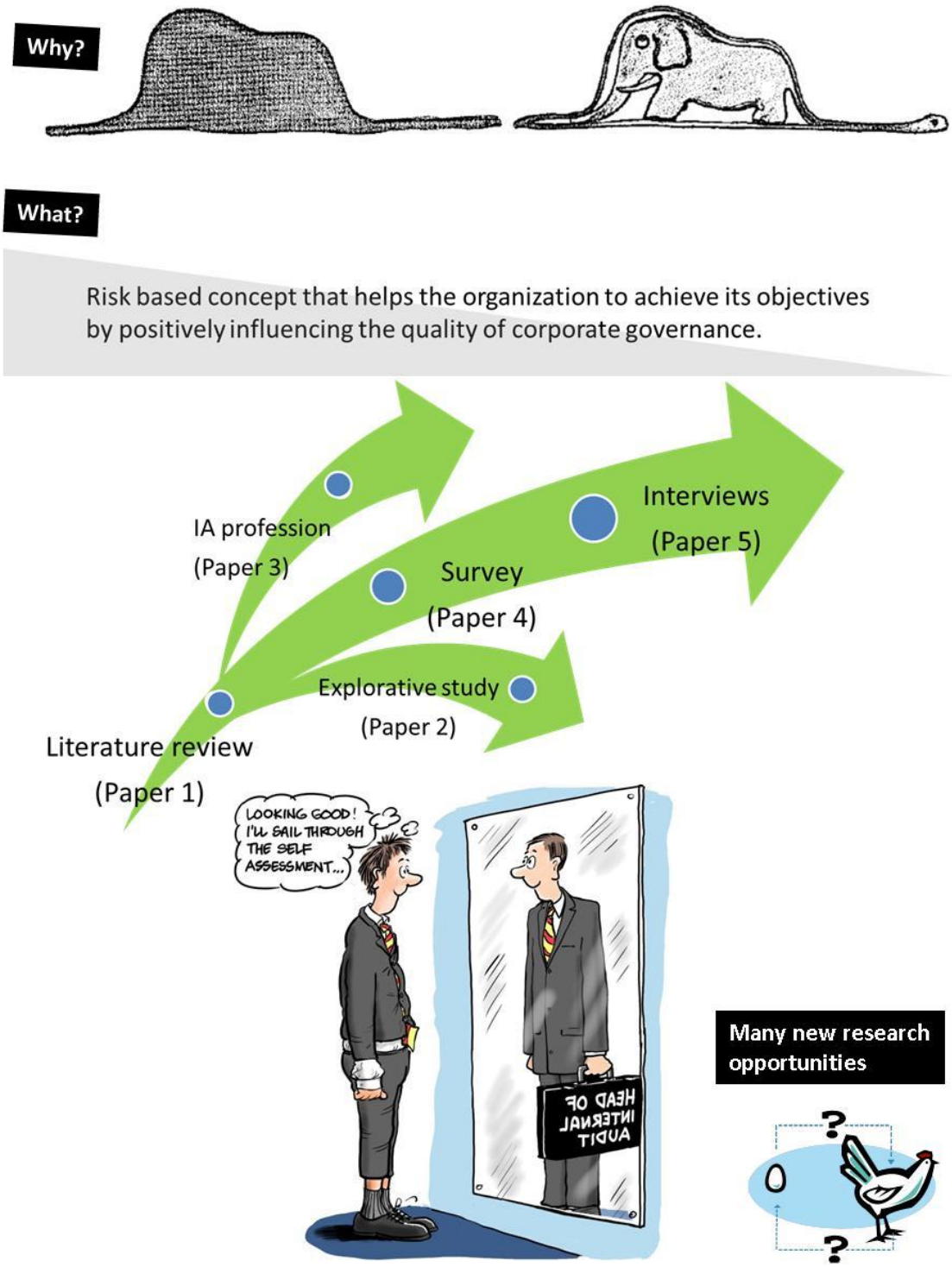
2. Is it possible to justify cases of IA effectiveness based on indicators among others, like fraud or financial performance? If so why does a more effective IA lead to less fraud and better financial performance?

My dissertation and the provision of a fresh agenda for future research opportunities in IA will hopefully encourage further studies. While this dissertation provides some insights into IA effectiveness, the wealth of research questions that come out of it are also an important contribution. Questions can be more important than answers. I would be delighted to see my work become encouragement and a starting point for future scholarly studies since *"if you want to go quickly, go alone. If you want to go far, go together"* (an African proverb).

To understand the plurality in practice, we need to study the practice. Qualitative research is viewed as a particularly promising path to learn more about the world of IA. Experimental research is especially encouraged, as it would allow conclusions on the causality between factors in practice, which goes further than insights into associations.

"Nothing is quite so practical as a good theory."
(Lewin 1945)

Figure 6: Summary of my PhD dissertation[10]

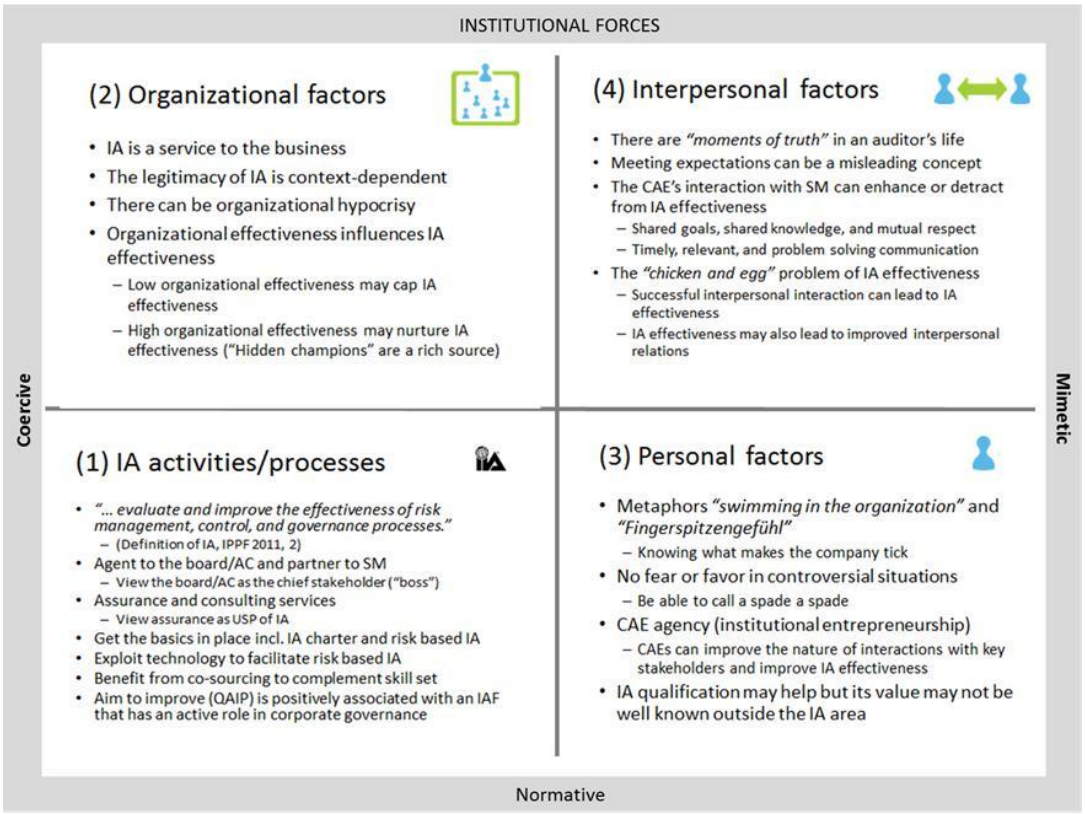


[10] Independent Audit Limited (http://www.independentaudit.com) gave their consent for using the diagram "Looking good - I'll sail through the self-assessment".

How?

Paper	Method/type	Perspective/theory
1	Literature review	New-institutional theory and entrepreneurship (DiMaggio and Powell
2	Explorative work	CBOK (2006) data from 782 U.S. CAEs
3	Conceptual paper	Critical reflections on the IA profession
4	Empirical survey	Questionnaire data from 46 German CAEs
5	Qualitative research	16 semi-structured interviews with CAEs and Senior Management in the same organization. Applied role theory (Kahn *et al.* 1964) in combination with the theory of relational coordination (Gittell 2006)

Results / Key findings



Louvain School of Management
Doctoral Thesis Series

Insights into the effectiveness of internal audit: a multi-method and multi-perspective study

Rainer LENZ

This doctoral dissertation includes five related working papers that provide valuable contributions to the understanding of internal audit (IA) and its effectiveness. Paper 1 is a literature review that uses the perspective of new institutional theory as a framework and acknowledges that IA effectiveness is largely still viewed as a "black box" that is under-explored in academic research. Paper 2 is an explorative work that studies the variables that are theoretically associated with the IA function's active role in corporate governance. This paper was published in the *Journal of Applied Accounting Research* (JAAR 2012). Paper 3 is a conceptual essay that discusses the status of IA as a profession and questions why the IA profession has not generally been seen as playing a significant role in the financial crisis, either as part of the problem or as part of the solution. This paper was published in the *Managerial Auditing Journal* (MAJ 2012). Paper 4 is an empirical survey that clarifies the discriminatory power of characteristics suggested by practitioners and academic research that may indicate IA effectiveness. Paper 5 is a qualitative research paper that breaks new ground in applying role theory (Kahn *et al.* 1964) in combination with the theory of relational coordination (Gittell 2006) to the research context of IA effectiveness. This dissertation builds on an exhaustive literature review, provides a mix of different methods and perspectives and offers innovative and complementary insights that open the door for further research.

Rainer LENZ has masters degrees in business and economics from universities in the UK (De Montfort University, Leicester), France (Université de Savoie, Chambéry), and his native Germany (University of Witten/Herdecke). He is a Certified International Investment Analyst (CIIA) and a Chartered Internal Auditor (CMIIA). His purpose is to make the internal audit function effective in practice, which led to this doctoral research.

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Insights into the effectiveness of internal audit

Rainer LENZ

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